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No. 89-1283

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

ARCADIA, OHIO, *et al.*,
Petitioners,

v.

OHIO POWER COMPANY, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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JOINT APPENDIX

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PETITION FOR WRIT OF CERTIORARI FILED FEBRUARY 9, 1990
CERTIORARI GRANTED MARCH 26, 1990

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FEDERAL ENERGY REGULATORY COMMISSION

RELEVANT DOCKET ENTRIES

Accession No.	Date	Proceedings
8208310540	5/28/82	Suppl. 12 to Elec. Rate Schedule 18 of OH Power Co.: SVC to Wheeling Elec. Co.
8206010174	5/28/82	OH Power Co. Revised Tariff Sheets to Tariff MRS. Comparative Billing Analysis, Testimony & Annual Rpt. included
8206100205	6/09/82	Notice that on 5-28-82 OH Power Co. File Charges in Rate Schedule 18
8306030145	6/01/83	Transcript of 830601 Hearing Held at Washington, D.C. Re OH Power Co., pp 9-198
8306080415	6/02/83	Transcript of 830602 Hearing Re OH Power, pp 199-367
8306080422	6/03/83	Transcript of 830603 Hearing Re OH Power Co., pp 368-496.
8306090407	6/06/83	Transcript of 830606 Hearing Re OH Power Co., pp 497-707
8306080561	6/07/83	Transcript of OH Power Co. 830607 Hearing in Washington, D.C. pp 708-900
8306130199	6/08/83	Transcript of 830608 Hearing Held in Washington, D.C. Re OH Power Co., pp 901-1078
8306140487	6/09/83	Transcript of OH Power Co. 830609 Hearing in Washington, D.C., pp 1079-1211
8312190251	12/14/83	Initial Decision by Presiding Law Judge

Accession No.	Date	Proceedings
8402220006	2/21/84	Brief on Exceptions in the Matter of OH Power Co.
84002220058	2/21/84	Commission Staff Brief on Exceptions to Initial Decision in re OH Power Co.
8402230092	2/21/84	Brief on Exceptions of Municipal Wholesale Elec. Customers of OH Power Co. to Initial Decision of Administrative Law Judge
8402230085	2/21/84	Forward Brief on Exceptions of Municipal Wholesale Elec. Customers of OH Power Co. re ER-82-553-000 & ER-82-554-000
8403210197	3/19/84	Forwards Brief of OH Power Co. Opposing Exceptions to D.W. Miller, Presiding Administrative Law Judge Initial Decision
8403210338	3/20/84	Forwards Brief of Municipal Elec. Customers of OH Power Co. Opposing Exceptions re: Subj. Dockets
8403210360	3/20/84	Forwards Staff Brief Opposing Exceptions to Initial Decision Re OH Power Co.
8403210198	3/20/84	Brief of OH Power Co. Opposing Exceptions to D.W. Miller, Presiding Administrative Law Judge, Initial Decision
8403210342	3/20/84	Brief of Municipal Wholesale Elec. Customers of OH Power Opposing Exceptions Re: Subj. Dockets
8403220031	3/20/84	Commission Staff Brief Opposing Exceptions to Initial Decision re: Ohio Power
8705080024	4/30/87	Opinion and Order on Ohio Power Co. Recovery of the Cost of Coal Purchased from an Affiliate

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

RELEVANT DOCKET ENTRIES

DATE	FILINGS—PROCEEDINGS
04-15-88	5-Petitioner's petition for review of an order of the FERC (m-15)
04-15-88	Clerk's order that the initial submissions and procedural motions due 05/16/88; dispositive motions due 05/30/88.
04-15-88	Certified copy of above order and petition for review was mailed to respondent(s).
05-16-88	5-Petitioner's docketing statement and initial submissions, deferred appendix-yes (m-16) (11 & 22)
05-16-88	CERTIFIED INDEX TO RECORD
05-16-88	5-Motion of New England Power Company for leave to participate as amicus curiae (m-16)
05-18-88	5-Motion for leave to intervene of the Municipal Wholesale Electric Customers of Ohio Power Co., time having expired (m-10) (11)
05-16-88	5-Motion for leave to intervene of LCP Chemicals & Plastics, Inc. Mobay Corp., Olin Corp., and PPG Industries, Inc. (m-13) (11)
05-26-88	5-Response of Ohio Municipal Customers opposing motion of New England Power for leave to participate as amicus curiae (m-26) (11) (6) (23)
07-14-88	Clerk's order granting all motions for leave to intervene.
08-11-88	Per Curiam order granting motion of New England Power Company for leave to participate as amicus curiae. Robinson, Silberman and D.H. Ginsburg, CJs

DATE	FILINGS—PROCEEDINGS
08-24-88	Clerk's order that this case has been scheduled for oral argument on Friday, Feb. 24, 1989 at 9:30 a.m. before Circuit Judges Mikva, Silberman and Sentelle. The following schedule shall apply: Petitioner's Brief—Oct. 28, 1988; Amicus Curiae in support of Petitioner—Nov. 16, 1988; Respondent's Brief—Dec. 19, 1988; Intervenor's Brief in support of Respondent—Jan. 6, 1989; Petitioner's Reply Brief, if any and Intervenor's Reply Brief in support of Petitioner—Jan. 24, 1989; Deferred Appendix—Jan. 31, 1989; and Final Briefs—Feb. 7, 1989. Briefs must be delivered to the Clerk's office by the date indicated to be considered timely filed. A further order of the Court will be issued regarding allocation of time for argument.
10-26-88	7-PETITIONER'S BRIEF (Ohio Power Company) (m-26)
11-08-88	5-Motion of New England Power Company to withdraw as amicus curiae (m-7) [8]
11-14-88	Per Curiam order granting motion of New England Power Company to withdraw as amicus curiae. The Clerk shall note the docket accordingly.
11-16-88	8-Errata sheet for Petitioner's—Ohio Power Company—Brief. (M-16)
12-19-88	7-Respondent's Brief. (M-19)
01-06-89	7-Intervenors' Brief. (M-6)
01-24-89	8-REPLY BRIEF FOR PETITIONER (m-24) [25]
01-31-89	7-Joint Appendix Volumes 1 & 2. (M-31) (6-25)
02-01-89	7-Errata to joint appendix. (6-25) (m-1)
02-07-89	15-FINAL Intevenors' brief. (M-7) (6-25)
02-07-89	15-FINAL Respondent's brief. (M-7) (6-25)

DATE	FILINGS—PROCEEDINGS
02-07-89	15-FINAL Petitioner's Brief. (M-7) (6-25)
02-07-89	15-FINAL Petitioner's Reply Brief. (M-7) (6-25)
02-17-89	Clerk's order, sua sponte, that the following times are allotted for the oral argument: Petitioner —15 min.; Respondent—15 min. Respondent may share time with intervenor.
02-24-89	ARGUED before Circuit Judges Mikva, Silberman and Sentelle. Inactive Bin No.
07-28-89	Opinion for the Court filed by Circuit Judge Sentelle.
07-28-89	Concurring opinion filed by Circuit Judge Mikva.
07-28-89	Judgment by this Court that the petition for review is granted, the order of the Commission is vacated, and the case is remanded, all in accordance with the Opinion for the Court filed herein this date.
07-28-89	Mandate order.
09-11-89	20-Petition for Rehearing and Alternative Suggestion for Rehearing En Banc Submitted by Intervenor Ohio Municipals (m-11) [1]
09-11-89	20-Petition of the FERC for Rehearing and Suggestion for Rehearing EN BANC (m-11) [1]
09-12-89	5-Respondent's motion for leave to substitute corrected copies of petition for rehearing. (M-12) (1)
09-15-89	Per Curiam order granting respondent's motion for leave to file substitute copies of petition for rehearing.
09-15-89	20-Petition of the FERC for rehearing and suggestion for rehearing *en banc*. (M-11) Filed per above order. (1)

DATE	FILINGS—PROCEEDINGS
10-12-89	Per curiam order denying respondent's and intervenor's (Ohio Municipals) petitions for rehearing. Judge Mikva would grant petitions; his statement attached to order. Mikva, Silberman and Sentelle, CJs
10-12-89	Per curiam order, en banc, denying respondent's suggestions for rehearing en banc. CJ Wald, Mikva, Edwards, Ruth B. Ginsburg, Silberman, Buckley, Williams, D.H. Ginsburg and Sentelle, CJs
01-24-90	MANDATE ISSUED.
01-04-90	Notice from Clerk's Office, U.S. Supreme Court that the Chief Justice signed an order extending the time for filing writ of certiorari to and including 2/9/90 [1]
03-27-90	Letter from US Supreme Court Clerk's Office dated 3/26/90 forwarding Supreme Court order dated 3/26/90 allowing certiorari. [1]

FEDERAL ENERGY REGULATORY COMMISSION

Docket Nos. ER82-553-000 and ER82-554-000

OHIO POWER COMPANY

INITIAL DECISION

(Issued December 14, 1983)

David W. Miller, Presiding Administrative Law Judge

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Appearances

Edward J. Brady, Marcia I. Resnick, Alan Kessler and *William E. Olson* for Ohio Power Company

William H. Roberts and *Richard E. Hitt* for Public Service Commission of West Virginia

Paul Nordstrom, Glen L. Ortman and *Kenneth E. Natale* for Municipal Wholesale Customers of Ohio Power Company

Philip Nelson and *O. C. Hall* for Wheeling Electric Company

James D. Kauffelt for Linden Chemicals and Plastics, Inc., Mobay Chemical Corporation, Olin Corporation, PPG Industries, Inc. (Industrials)

Melvin Berger, Arthur Hays Butler, Lawrence R. Greenfield, Michael Small and *James E. Rogers, Jr.*, for the Staff of the Federal Energy Regulatory Commission

I. Background

On May 28, 1982, the Ohio Power Company (OPCO) submitted for filing increased rates in Docket No. ER82-553-000 for service to fifteen municipalities located in Ohio, and in Docket No. ER82-554-000 for service to its affiliate, Wheeling Electric Company. By order issued July 23, 1982, the Commission accepted the rates for filing to become effective on December 28, 1982, for service to the fifteen municipalities, and on July 29, 1982, for service to Wheeling Electric Company, both subject to refund, and consolidated the dockets for hearing and decision. *Ohio Power Company*, 20 FERC ¶ 61,081 (1982).

In response to OPCO's filing in Docket No. ER82-553-000, the Villages of Arcadia, Bloomdale, Carey, Cygnet, Deshler, Greenwich, Ohio City, Plymouth, Republic, Shiloh, Sycamore, Wapakoneta and Wharton, and the Cities of Bryan and St. Clairsville, Ohio (Municipals), filed a petition to intervene. In Docket No. ER82-554-000, the industrial customers of Wheeling Electric Company, namely, Linden Chemicals and Plastics, Inc., Mobay Chemical Corporation, Olin Corporation, and PPG Industries, Inc. (Industrials), petitioned to intervene. The Public Service Commission of West Virginia (WVPSC) also filed a timely Notice of Intervention. The Commission's order of July 23, 1982, granted all the interventions.

Settlements of all matters except for what was termed the captive coal issue were filed in both dockets, and were accepted by Commission orders dated May 18, 1983, and July 8, 1983, respectively. *Ohio Power Company*, 23 FERC ¶ 61,236 (1983), *Ohio Power Company*, 24 FERC ¶ 61,017 (1983).

Hearings were held on the captive coal issue on June 1-9, 1983, and on July 12-13, 1983 (transcript pages 9-1529); post-hearing briefs were filed and considered.

In brief, the Staff, supported by the Municipals and WVPSC, contends OPCO has included roughly $20 million too much in its annual cost-of-service because the coal it purchased from a wholly-owned subsidiary, Southern Ohio Coal Company, which was mined at the Martinka mine, exceeded by that amount what comparable non-affiliate coal could have been purchased for. Staff Initial Brief, page 2; WVPSC Initial Brief, page 9; Municipals Initial Brief, page 4. Of this $20 million, roughly $2 million is allocable to customers under FERC jurisdiction. OPCO Initial Brief, page 11.

In brief, OPCO states its position by posing three questions, each of which it would answer in the negative (OPCO Initial Brief, pages 1, 2):

(1) Can the Commission impose a market price standard here since the price paid for the Martinka coal is regulated by the Securities and Exchange Commission (SEC) and the Public Utilities Commission of Ohio (OPUC)?

(2) Has the Commission adopted a broad policy mandating that affiliated coal supplies be treated as presumptively unreasonable and subject to automatic adjustment to the level of a hypothetical market price?

(3) Assuming an affirmative answer to question (2), has Staff met its burden of showing it used an appropriate methodology?

II. Factual Setting

A. *Corporate Relationships and Use of Martinka Coal at Mitchell Plant*

The America Electric Power Company (AEP) is a large, public utility holding company which provides electric service at wholesale and retail over a seven state area, through eight principal subsidiary operating companies (Exh. 15, page 6):

> Appalachian Power Company, Columbus and Southern Ohio Electric Company, Indiana & Michigan Electric Company, Kentucky Power Company, Kingsport Power Company, Michigan Power Company, Ohio Power Company, and Wheeling Electric Company.

Ohio Power (OPCO) provides electric service in eastern, east central, southern, and northwestern Ohio. Exh. 1, pages 3-4. Wheeling Electric provides electric service in northern West Virginia and has no generating facilities of its own. Exh. 15B, page 1. Wheeling Electric purchases all of its power from OPCO. Id.

OPCO has three subsidiary companies actively engaged in the mining of coal. Exh. 15, page 6. One of these, Southern Ohio Coal Company (SOCCO), currently operates coal mines in both Ohio and West Virginia. Id. The West Virginia coal mine—the Martinka mine—is a deep mine located in Marion County, West Virginia, near the town of Fairmont. Id; Exh. 4A, pages 4-5, 14.

Coal from the Martinka mine is transported by rail to and burned at OPCO's Mitchell generating plant located along the Ohio River near Captina, West Virginia. Exh. 15, page 7. *See* Exh. 15G for locations of the Mitchell plant and Martinka mine. The delivered cost of coal from the Martinka mine consists of the cost of coal at the Martinka mine plus the cost of transporting the coal from the Martinka mine to Mitchell. Exh. 15, page 11; *see* Exh. 15H which is a copy of the sales contract between SOCCO and OPCO at page 4. The cost of coal at the Martinka mine includes full recovery of all costs plus a return on the capital invested in the mine. Exh. 4, page 22.

Coal for OPCO's generating plants, all of which are coal-fired, is procured not by OPCO but by the Fuel Supply Department of the American Electric Power Corporation (AEPSC), the management, professional, and technical service company for the AEP system. Exh. 15, page 7. The service company is charged with procuring fuel for all of AEP's subsidiary operating companies, including OPCO. Id. The service company is responsible not only for procuring coal from non-affiliated mines but also is responsible for the operation of AEP's and, hence, OPCO's affiliated mines. Id. AEP is the nation's largest single purchaser of coal. Id. at 10. In calendar year 1981, AEP consumed some 41.6 million tons of coal and OPCO's own generating plants consumed some 14 million tons of coal. Id. at 10.

B. *Mitchell Plant*

Mitchell has two coal-fired units, each with a nameplate capacity of 800 MW. Exh. 2, pages 5-6. Because of problems with a Westinghouse generator, unrelated to the coal being burned, Mitchell Unit No. 1 is currently rated at only 660 MW. Id. at 6.

Mitchell Unit No. 2 has a history of being unavailable due to coal-related causes almost twice as often as another plant, Amos 1, which went in service at the same time as Mitchell 2, in 1971. Exh. 32E, page 3. Amos 1 and Mitchell 2 are virtually identical units whose operations are distinguished only by the coal quality used at each unit. Tr. 256; Exh. 2, pages 5, 6.

After a study completed in April 1977, the Hall Report (Exh. 32E), which made the comparison of the Amos 1 and Mitchell 2 units, extensive tests were conducted to determine if the quality of the Consolidated Coal Company's McElroy coal which was being used in Mitchell

2 could be improved to a satisfactory level; when the tests proved negative, the decision was made to phase out the McElroy coal on the Mitchell units and replace it with a higher quality coal. Exh. 2, page 7. The change in fuel quality began in 1980 and, while there was not an instantaneous change, there has been an improvement in the forced outage rate at Mitchell 2. Tr. 278-79; Exh. 26.

Michael B. Doherty, Assistant Manager, Steam Generation Section, Plant Engineering Division, American Electric Power Service Corporation (AEPSC), testified that the Mitchell units are dry bottom boilers and as such perform more efficiently with coals having ashes with high melting temperatures. Exh. 3, page 9. He said "[u]ncontrolled slagging occurs when large amounts of molten ash occur in units where there is no mechanism built into the unit's design for its removal. This "[,in his view,] is the fundamental problem associated with using a wet bottom coal in a dry bottom unit such as has occurred at Mitchell." Id. In short, the McElroy coal which was used in the Mitchell units starting in 1971 until it was decided to upgrade the quality of coal used there in 1980 to Martinka coal was the cause of the excessive downtime in Mitchell 2 when compared to Amos 1. Id. at 40-45. Until 1978 the amount of McElroy coal received and burned at Mitchell did not exceed approximately 45% of the total burn on an annual basis. Id. at 41. The distinction between wet and dry bottom boilers refers to the method by which slag is removed from the boiler; slag on the boiler's floor is either in a molten or dry state. Id. at 9. A wet bottom boiler requires a coal with ash having a relatively low fusion temperature. Id at 9.

As to the scope of the slag problems in the Mitchell units, Mr. Doherty had personally observed slag and ash accumulations as much as 30-feet high, 14-feet wide and 40-feet across; although this is an extreme example, smaller accumulations, only the size of a pickup truck, have occurred on other occasions. Exh. 3, page 33.

C. Martinka Mine

The original basic coal supply for the Mitchell Generating Station was the McElroy mine which was planned and developed by the Consolidated Coal Company under contract. Exh. 4, pages 15, 16. The contract was dated December 30, 1966, with deliveries scheduled to begin on May 31, 1971, for a term of twelve (12) years. Id. at 16. When it was found that the operating results and characteristics of Mitchell did not even begin to compare with the operating results of nearly identical units at the Amos Generating Station, it was determined that the McElroy high sulfur, low ash fusion temperature coal could not be burned in Mitchell's boiler without creating slagging problems and advancing boiler tube erosion. Id. at 17. Rather than abandon use of the favorably priced McElroy coal, and in light of OPCO's contractual commitments for that coal, OPCO experimented with the McElroy coal to see what could be done to accommodate it in Mitchell's boilers. Id. at 17. By 1978 it became apparent the efforts to improve the quality of the McElroy coal used at Mitchell had not been successful. Id. at 17.

By 1978 the Martinka mine was in commercial operation and it was decided to use the Martinka coal at Mitchell and the results have been very favorable. Exh. 4, page 18. The background to the Martinka mine is a lease agreement between OPCO and the owners of the coal reserves in 1972. Id. This was a low sulfur supply of coal, and it was expected at that time that low sulfur eastern coal would become increasingly difficult to obtain. Id. at 19. OPCO considers the Martinka mine as fully developed and forecasts a production of 2.0 million tons of clean coal in 1983 at an average FOB mine cost of $38.81 per ton. Id. at 19, 20. Except for aberrations caused by labor strikes and difficult mining conditions the FOB mine costs for Martinka have been steadily improv-

ing on a constant dollar basis; the numbers are (id. at 20):

Years	*Actual Selling Price ¢/MBtu*	*Constant 1977 Dollars ¢/MBtu*
1977	152.1	152.1
1978 *	195.8	181.8
1979	204.5	170.6
1980	168.3	123.7
1981 *	246.3	163.9
1982	183.2	114.9

* Impacted by the UMWA strike

The Btu and sulfur content of Martinka coal in 1980-82 was about 11,800 Btu and 1.5% sulfur. Exh. 15P, Schedules 1, 2 at pages 12, 13 respectively; Exh. 15KK, page 12.

III. Significance of Securities and Exchange Commission (SEC) and Public Utilities of Ohio (OPUC) Regulation

A. Concerning the SEC Exclusive Jurisdiction Contention

1. OPCO Position

There is a conflict of jurisdiction between the Commission and the SEC. The price OPCO pays for coal from Southern Ohio's Martinka mine is set by a formula applied by the SEC under the Public Utility Holding Company Act of 1935 (1935 Act), 15 U.S.C.A. §§ 79a, *et seq.* In such a situation, Section 318 of the Federal Power Act, the Conflict of Jurisdiction provision, applies, and this Commission's jurisdiction over the pricing of OPCO's coal purchases from its affiliate must give way to the SEC's jurisdiction. OPCO Initial Brief, page 5.

2. Staff Position

OPCO seeks to manufacture a conflict with the SEC where none in fact exists. Put simply, the SEC's regulations do not require affiliate prices to be set at cost or equal to cost. They speak of "at not more than cost," and "does not exceed a fair and equitable allocation." OPCO, although free to charge up to cost, is also equally free to charge less than cost. Staff Reply Brief, pages 27, 28.

Section 318 also does not apply because this proceeding does not involve the "same subject matter" as the SEC's regulation. While the SEC regulates the price paid to the affiliate Martinka coal mine by Ohio Power, the Commission, in contrast to the SEC, is only interested in the price of affiliate Martinka coal as a cost the utility passes through its rates to ratepayers. In short, the SEC does not set rates while this Commission does. Staff Reply Brief, page 30.

3. West Virginia Public Service Commission Position

The rules promulgated by the SEC do not require a holding company subsidiary to price its service to be provided or a good to be sold by it at its cost. WVPSC Reply Brief, page 3. Rather, this service must be provided or the good sold at *no more than cost.* (17 C.F.R. § 250.90(a)(2).) Id. Moreover, if the holding company subsidiary actually produces the goods to be sold, those goods shall not be sold to an associate company "at a price which exceeds the price at which the purchaser might reasonably be expected to obtain comparable goods elsewhere . . . ." (17 C.F.R. § 250.92(b).) Id. at 3, 4.

The FERC's authority *to establish rates* for sales of electric energy at wholesale in interstate commerce should be recognized as separate and distinct from the SEC's authority *to apportion costs* among public utility holding company affiliates, WVPSC Reply Brief, page 5.

4. Municipals Position

In general the Municipals asserted positions similar to those advanced by the Staff and WVPSC. Municipals Initial Brief, pages 67,69-71; Municipals Reply Brief, pages 9-15, 18-24, 27-28.

To the best of the Municipals' knowledge, the SEC does not as a matter of course issue orders approving AEP's quarterly statements regarding affiliate coal, and has never issued an order specifically approving the price of Martinka coal. Municipals Reply Brief, page 16.

5. Discussion and Conclusion

The st .rting point for OPCO's position is Section 318 of the Federal Power Act which provides:

> Sec. 318. If, with respect to the issue, sale, or guaranty of a security . . ., *or any other subject matter*, any person is subject both to a requirement of the Public Utility Holding Company Act of 1935 . . . and to a requirement of this Act . . . the requirement of the Public Utility Holding Company Act of 1935 shall apply to such person, and such person shall not be subject to the requirement of this Act, . . . *with respect to the same subject matter*, unless the Securities and Exchange Commission has exempted such person from such requirement of the Public Utility Holding Company Act of 1935, in which case the requirements of this Act shall apply to such person. [Emphasis supplied.]

Assuming, *arguendo*, that SEC sets a price which Southern Ohio can charge OPCO for the Martinka coal, is that the "subject matter" which Section 318 refers to? If the SEC was dealing with "just and reasonable rates" for OPCO's jurisdictional customers, obviously the same "subject matter" would be involved. However, it appears SEC is regulating in a broad sense the relationship between the holding company and all its subsidiaries so that no one of the associated companies takes advantage of any other. The section of the Public Utility Holding Company Act of 1935 which OPCO cites as showing the "subject matter" SEC is acting toward is Section 13(b) reading in part:

> [I]t shall be unlawful for any subsidiary company of any registered holding company . . . to . . . sell goods to, any associate company thereof except in accordance with such terms and conditions and subject to such limitations and prohibitions as the [SEC] . . . by rules and regulations or order shall prescribe as necessary or appropriate in the public interest or for the protection of investors or consumers and to insure that such contracts are performed economically and efficiently for the benefit of such associate companies at cost, fairly and equitably allocated among such companies.

This language does not indicate SEC's subject matter in setting coal prices is the "just and reasonable" rates to be charged to OPCO's customers.

In conclusion, SEC, at the most, is regulating the sale of coal between Southern Ohio and OPCO for purposes of keeping a reasonable arm's-length relationship between the two associated companies, whereas the FERC is regulating the sale of electricity by OPCO to its customers. The subject matters are entirely different, and the "Conflict of Jurisdiction" provision of the Federal Power Act does not preclude the Commission from deciding what the "just and reasonable" rates are to be in this case, and in particular the proper amount to be allowed in the cost-of-service for the use of Martinka coal by OPCO.

OPCO asserts that the taking clause of the Fifth Amendment of the United States Constitution would be violated if the SEC and the Commission attempt to regulate the same subject matter and in so doing apply different standards, that is, the SEC a cost-of-service standard and the Commission a market price standard. OPCO Initial Brief, pages 8, 9; OPCO Reply Brief, pages 31-32. Absent the actual implementation of different standards so as to cause a taking of property it would be difficult to determine if the mere existence of the standards by

themselves would be unconstitutional. *See Hodel v. Virginia Surface Mining Reclamation Association, Inc.*, 452 U.S. 264, 294-95 (1981). In other words the constitutionality *vel non* of different standards could depend upon how the different standards are applied. But even if in implementation of different standards OPCO was limited in how its property could be used, for example, it could only sell to third parties at a profit, this type regulation is not necessarily violative of the Fifth Amendment. Most regulations limit the use of property in some way and yet do not result in a constitutional taking of property. For example, *see Andrus v. Allard*, 444 U.S. 51, 65 (1979), and cases discussed in Gelin and Miller, *The Federal Law of Eminent Domain* (1982), pages 55-67. Since the decision here does not find any basis for disallowing any part of the payments made for the Martinka coal it isn't necessary to rule on this claim.

B. Concerning the Effect of OPUC and SEC Establishing a Price for Martinka Coal in Conjunction with 18 C.F.R. 35.14(a)(7)

1. OPCO Position

18 C.F.R. 35.14(a)(7) reads in part: "Where the utility purchases fuel from a company-owned or controlled source, the price of which is subject to the jurisdiction of a regulatory body, such cost shall be deemed to be reasonable and includable in the adjustment clause." The "fuel cost adjustment clause" must conform to the principles set out in 18 C.F.R. 35.14 or it is not in the public interest. The fuel clause is to be in a form that provides for periodic adjustments per kWh of sales equal to the difference between the fuel cost per kWh of sales in the base period and in the current period. 18 C.F.R. 35.14(a)(1).

Staff has consistently recognized that regulation of affiliate fuel transactions by the SEC or by a state commission is sufficient to satisfy the rule's requirements and trigger its operation. OPCO Initial Brief, page 136. The

price charged to OPCO for Martinka coal is regulated both by the SEC and the Ohio Public Utility Commission (OPUC). OPCO Initial Brief, pages 137, 141.

2. Staff Position

Section 35.14(a)(7) of the Commission's regulations does nothing more than establish a rebuttable presumption that, in the absence of a showing to the contrary, fuel prices subject to another agency's regulatory jurisdiction are reasonable. This is borne out by Section 35.14(a)(10) of the Commission's regulations, which provides that the Commission may waive any part or all of its fuel adjustment clause regulations, including Section 35.14(a)(7). Staff Reply Brief, page 37. Furthermore, Section 35.14(a)(7) can no longer be considered a bar to this Commission's review of Ohio Power's affiliate coal prices in light of the subsequent passage of Section 208 of the Public Utility Regulatory Policies Act of 1978 (PURPA). 16 U.S.C. § 842d(f) (Suppl. II 1978.) Id. at 41.

It would be inappropriate for the Commission to defer to the SEC as to the reasonableness of affiliate coal prices; the SEC is not guided by the same statutory standards as is the Commission and the interests protected by the SEC are not necessarily the same interests protected by the Commission. Staff Reply Brief, page 48. This Commission has an independent obligation under the Federal Power Act to ensure that rates are just and reasonable. 16 U.S.C. §§ 824d(a), 824(e) (1976). Id. at 50.

Although the Public Utilities Commission of Ohio has jurisdiction over Ohio Power's retail rates and the allowance of costs that are to be recovered in those rates, it has no authority over the price actually charged by Southern Ohio Coal Company to Ohio Power. Staff Reply Brief, page 51. Section 35.14(a)(7) requires that state regulatory authority must encompass the price paid for coal sold by the affiliate coal mine to the utility. Id. at 53.

3. West Virginia Public Service Commission Position

The Wheeling Electric Company should not be forced to pay rates which include excessive affiliated coal costs. This is a decision that is appropriate for either the West Virginia Commission or the FERC—it is definitely not one to be made by the Public Utilities Commission of Ohio pursuant to Rule 35.14(a)(7). WVPSC Initial Brief, page 7. The West Virginia Commission has historically repriced the affiliated coal of Appalachian Power Company and Virginia Electric and Power Company whenever the cost of that coal exceeds the cost of non-affiliated coal. Id.

4. Municipals Position

In general, the Municipals take positions similar to those of the Staff. Municipals Initial Brief, page 66-72.

The Public Utility Commission of Ohio does not and cannot exercise regulatory authority over OPCO's coal investments similar to that which it or the FERC exercise over OPCO's utility operations. Municipals Reply Brief, page 32. It does not and cannot conduct a cost of service analysis of Southern Ohio's coal operations and therefore is incapable of determining whether Southern Ohio's costs are reasonably incurred under a cost-based standard; alternatively, it has not employed a market-based standard. Id. To the extent the Commission relies on the Ohio Commission's limited authority to regulate OPCO's recovery of Martinka coal costs on the retail side, it fails to protect the interests of the Municipals and OPCO's other FERC jurisdictional customers and to ensure that OPCO recovers only costs reasonably incurred. Id.

5. Discussion and Conclusion

Although it is possible to read the language of 18 C.F.R. 35.14(a)(7) as OPCO does, it is also possible to read it as the Staff does. Consequently the interpretation

made by Federal Power Commission Chairman John N. Nassikas in the letter of May 15, 1975, to the Senate Subcommittee (Appendix E to the Staff's Reply Brief) is important. That letter speaks of the regulation as creating a presumption of reasonableness. Letter at page 15. Chairman Nassikas' interpretation is consistent with the obligation placed upon the Commission to regulate wholesale rates within a certain sphere and the Commission's rejection of efforts by State commissions to establish wholesale rates in interstate commerce either directly or indirectly. *E.g., Western Massachusetts Electric Company*, 23 FERC ¶ 61,345. It is noted that OPCO in its Initial Brief, page 137, refers to 35.14(a)(7)'s presumption of reasonableness.

Staff's argument that SEC is not regulating in the sense of 18 C.F.R. 35.14(a)(7) is at odds with the language of 35.14(a)(7), specifically the reference to prices for fuel purchases which is precisely what SEC regulates. The Staff argument that OPUC, like FERC, is regulating the rates rather than specific elements going into the rates is more persuasive. If important, which it isn't here, this argument would require further analysis before a conclusion could be reached as to the consequences of an OPUC finding that the Martinka prices are reasonable. Since SEC uses the cost-of-service regulation approach to the Martinka coal prices, at least to the extent that SEC actually applies that approach, 18 C.F.R. 35.14(a)(7) would be applicable. It isn't clear that SEC has in fact ever monitored the cost-of-service claims made with respect to the Martinka coal and before the presumption of reasonableness provided by 18 C.F.R. 35.14(a)(7) would come into play it would be necessary to have more information on this point. However, the situation would be no different here whether or not 35.14(a)(7) had created such a presumption. The serious doubt Staff created in its presentation cancels out any such presumption and brings into play the burden of proof rules discussed hereafter in Part V.

Even if OPCO's position was accepted *vis-a-vis* the Public Utility Commission of Ohio's actions respecting the Martinka coal, there is no reason to bind the West Virginia customers by the Ohio Commission actions. The position of the West Virginia Public Service Commission is sound.

IV. Precedential Effect of Commission Opinion No. 133

A. OPCO Position

Accepting, *arguendo*, that the Commission has jurisdiction to adjust the cost-of-service price paid for the Martinka coal, and that it has not already decided the price set by SEC is reasonable under its own regulations, the Commission decision in *Public Service Company of New Mexico*, Opinion No. 133, 17 FERC ¶ 61,123 (1981), did not establish a broad principle that a cost-of-service approach should be abandoned and a market price approach used in all cases where the appropriateness of the transfer price of affiliate coal is brought into issue. OPCO Initial Brief, pages 147-48.

B. Staff Position

Commission precedent mandates the use of a market price standard to judge the reasonableness of affiliate coal prices. Staff Initial Brief, page 12.

C. Discussion and Conclusion

1. History of Opinion No. 133

An Initial Decision preceding Opinion No. 133 was issued January 25, 1980 (10 FERC ¶ 63,020). One issue was the "costs related to 'captive' coal (*i.e.*, that coal purchased from a subsidiary enterprise) for the cost-of-service treatment." *Id.* at 65,142. The coal was purchased by Public Service Company of New Mexico (PNM) from a 50%-owned subsidiary, Western Coal Company (WCC). *Id.* at p. 65,142. PNM had placed in its cost-of-service

the price paid to WCC, and that price was considered to be the market price. Staff urged that WCC should only be paid what WCC's cost-of-service would justify, and that this price would be below the so-called market price. Judge Harfeld decided that the market standard methodology should be used instead of the cost-of-service approach urged by Staff. *Id.* at 65,143. This decision dealt with a locked-in-period, and before it was passed upon by the Commission the parties entered into a settlement agreement. However, Judge Harfeld considered the "captive coal" issue again respecting a later PNM rate filing in an Initial Decision issued November 28, 1980 (13 FERC ¶ 63,041), and affirmed his earlier holding. Id. at p. 65,171. This later Initial Decision was affirmed, in pertinent part, by the Commission in Opinion No. 133.

Since, as noted hereafter, the Commission not only affirmed Judge Harfeld's conclusion but also approved his reasons, the reasoning found in his decisions are reviewed.

Judge Harfeld reasoned in the first Initial Decision (10 FERC ¶ 63,020) that the affiliated coal supplier should not be treated as a public utility and required to earn the identical rate of return on common equity as the parent company; adoption of a strict cost-of-service test to determine the price the affiliated coal supplier could charge its parent would likely discourage coal affiliation with electric utilities; the same incentives should be given to the development of coal supplies as are given for the exploration and production of natural gas by pipeline affiliates, and legal precedent in natural gas cases supports the use of a market standard for testing the reasonableness of the price of fuel charged by an unregulated wholly-owned gas pipeline subsidiary to its regulated electric utility parent—the court reasoned that not permitting the gas pipeline subsidiary to charge its parent the market price could lead the parent to buy gas elsewhere and cause the subsidiary to sell its gas on the market; the Commission has a standard of "prudent cost incur-

rence" for testing expenses incurred by a regulated company. Within the legal framework of "prudent cost incurrence" Judge Harfeld decided that the "proper test [in the case before him] is a market approach comparing the contract coal price with prevailing market coal prices to determine whether these coal costs were prudently incurred." 10 FERC at p. 65,144. Judge Harfeld also noted that the market test is consistent with the Commission's policy respecting non-jurisdictional shipping charges in liquefied natural gas import proceedings where corporate affiliation existed between the regulated importer or the interstate pipeline hiring the ships and the non-regulated shipping company; in particular he quotes from a Commission order that states: "If the rate paid here is comparable with rates charged for the same or similar services by this or any other shipping company, our investigation as to this item would be at an end." Id. at p. 65,145.

Judge Harfeld's decision was directed to a case where the contention was that the price paid to the affiliated coal supplier was higher than the coal supplier's cost-of-service, and the price allowed in the utility's cost-of-service should be the actual cost reflected by the coal supplier's cost-of-service.

As noted earlier Judge Harfeld's Initial Decision in the above case was not acted on by the Commission since the parties entered into a settlement after the decision issued. However, the reasoning of that decision is important since Judge Harfeld affirmed his earlier decision when the same issue came up in the later case. *See* 13 FERC at p. 65,171. The later case, which is another PNM one, is reported at 13 FERC ¶ 63,041 and was ultimately affirmed by the Commission in Opinion No. 133.

Judge Harfeld's reasoning in his second Initial Decision is substantially the same as in the first decision. However, he found support for the earlier decision in the

Commission's "stand alone" theory of ratemaking which is stated to be that "neither regulated companies nor their affiliates should receive less revenue from their sales due solely to the mere affiliation between supplier and purchaser." 13 FERC at p. 65,169.

Judge Harfeld's discussion and reliance on market price evidence covered some matters presented in this hearing. One issue was whether the captive coal price was to be compared to a single weighted average price derived from other coal contracts or with a range of prices under other coal contracts. Even though the Staff supported a single weighted average price it did not say such a comparison alone would establish the unreasonableness of the captive coal price. 13 FERC at pp. 65,171, 65,173. Judge Harfeld decided that neither approach had been shown to be superior and therefore "a reasoned exercise of judgment and discretion must involve consideration of all proffered approaches." Id. at p. 65,174.

Judge Harfeld also decided that comparable market prices include those executed prior to the test year. 13 FERC at p. 65,173.

Whereas Judge Harfeld concentrated in his first decision on a situation where it was assumed the market price was higher than the cost-of-service, this is not mentioned in the second decision and at least in passing he addressed the situation where the cost-of-service is higher than the market price (13 FERC at pp. 65,170-71):

> Under a cost-of-service approach, the Company's coal expenses could be deemed to be cost-justified, yet higher than what they would be if PNM purchased its coal elsewhere. Clearly . . . public utilities are required to operate with all reasonable economies . . . . The [cost-of-service standard] would permit public utilities to engage in a course of action the

effect of which would be contrary to the best interests of the ratepayers. (Footnotes omitted.)

In Opinion No. 133, issued November 9, 1981, the Commission did more than just affirm Judge Harfeld's conclusion, it discussed at least some of the reasons for the affirmation (17 FERC at pp. 61,245-46):

> We affirm the judge's conclusion that the reasonableness of the cost of coal purchased from an affiliate should be determined by comparison to the prices of coal available from non-affiliated suppliers. *We believe that the interests of consumers will best be protected by permitting utilities that purchase coal from affiliates to recover no more from their rate-payers than the price that would have been incurred if a comparable coal supply contract had been made with a non-affiliated supplier.*
>
> An attempt to test the reasonableness of coal costs by a cost-of-service analysis of an affiliated supplier would extend the scope of our rate-making analysis to an industry in which we have very little expertise . . . . Furthermore, fuel prices that may appear reasonable under a cost-of-service test may be higher than prices from non-affiliated suppliers . . . . *We believe that the best incentive for utilities to develop the least costly sources of fuel is to limit their fuel expense recovery from affiliated suppliers to amounts equal to prices available from non-affiliated suppliers in a competitive market.*
>
> We recognize the difficulties in identifying comparable prices . . . . The price comparison should . . . consider differences in the quality of the coal available from non-affiliated coal suppliers and that of the affiliate, such as sulphur, ash and moisture content, as well as Btu rating. Price differentials may also be justified with respect to the reliability of supply from the alternative suppliers compared to that of the affiliate, and to different market circumstances at the time long-term contract prices were negotiated. (Emphasis supplied.)

In a Commission order issued March 29, 1982, regarding a still later PNM rate filing, the Commission affirmed its holding in Opinion No. 133 respecting "captive coal" purchases not only for the reasons stated in Opinion No. 133 but also for the reasons stated by Judge Harfeld in his Initial Decision. 18 FERC ¶ 61,276. And in another PNM rate case treated in Opinion No. 164 (1983), the Commission again affirmed its decision in Opinion No. 133. 23 FERC ¶ 61,218 at p. 61,457.

In another PNM case Judge Gordon applied the market price test which the Commission approved in Opinion No. 133. 18 FERC ¶ 63,005 (1982). Of particular interest is the fact that Judge Gordon approved as reasonable a price paid for affiliated coal which was somewhat higher than the weighted average price of coal in a region used for purposes of comparison. Id. at pp. 65,023-24. The Commission affirmed Judge Gordon on this matter in Opinion No. 146, 20 FERC ¶ 61,290 (1982), for the reasons stated in the Initial Decision. Id. at p. 61,545.

2. Conclusions as to the Precedential Value of Opinion No. 133

Notwithstanding that the "captive coal" issue came up initially before Judge Harfeld in the context of the market price being greater than the coal supplier's cost-of-service, the reference in Judge Harfeld's second decision (13 FERC at pp. 65,170-71) and in the Commission's Opinion No. 133 about limiting the utility's pass through to ratepayers to a market price makes it clear the Commission envisions use of the market price test in instances where the market price is either above or below the coal supplier's cost-of-service.

Also it is clear that the Commission did not have in mind one set way of determining market price for all cases, or for the use of a single weighted average price as the sole reference point. Judge Harfeld concisely stated how market price evidence is to be employed: "a reasoned exercise of judgment and discretion must involve consideration of all proffered approaches." 13 FERC at p. 65,174. This reasoning, which the Commission later approved, plus the Commission's statements in Opinion No. 133 about the difficulty of determining the market price and the need to consider coal qualities, reliability of supply and different market circumstances at the time long-term prices were negotiated, lead to the conclusion that parties cannot be limited to any particular way to approach market price. The end result is to determine if the utility seeks to recover "more from their rate-payers than the price that would have been incurred if a comparable coal supply contract had been made with a non-affiliated supplier." The word "comparable" connotes the need for judgment on many matters and fits in with Judge Harfeld's observation that an exercise of judgment and discretion is involved.

V. Staff's Market Evidence

The Staff relied upon two witnesses to make its presentation on the applicable market price. First, John Pyrdol, Industry Economist, Energy and Fuels Analysis Branch, Office of Electric Power Regulation, Federal Energy Regulatory Commission, developed a methodology by which to judge the reasonableness of affiliated fuel purchases (Exh. 13, page 3), and second, Dr. Eugene V. Kleber, Physical Scientist, Energy and Fuels Analysis Branch, Office of Electric Power Regulation, Federal Energy Regulatory Commission, applied Mr. Pyrdol's methodology to determine a market price for coal delivered to the Mitchell generating plant in order to evaluate the reasonableness of the price Ohio Power pays for the affiliated coal (Exh. 15, pages 10, 11).

A. Mr. Pyrdol's Methodology

Mr. Prydol undertook to explain why the price of affiliated coal from the Martinka mine should be compared to market prices as a test of reasonableness, and why such market-price test is valid from an economic perspective and is consistent with the purposes of utility regulation. Exh. 13, page 4.

The thrust of Mr. Pyrdol's testimony on the need for a market-price test is the difference between arm's-length open market transactions and inter-affiliate transactions; in the first case the utility has something to lose if it accepts a higher than market-competitive price, whereas in making purchases from an affiliated mine the utility's incentive to pay the lowest possible price may be blunted. Exh. 13, page 5. Hence, in the arm's-length transaction it may be assumed the utility has acted prudently, but a similar assumption cannot be made for inter-affiliate transactions. Id. In line with this thinking, Mr. Pyrdol would have different rules for deciding if a particular coal price should not go into the cost-of-service (*id.* at 6):

(1) Arm's-length transaction: Imprudence must be established in addition to a high price; and

(2) Inter-affiliated transaction: A simple showing that the inter-affiliate price is higher than the market price should automatically result in limiting the inter-affiliate price to market price.

From an economic theory standpoint, Mr. Pyrdol found the market-price concept to be sound. He testified that there is an "economic precept that the price prevailing in competitive markets represents the marginal costs of, in this instance, coal supply, under conditions of efficient management of resources. If goods and services are purchased by a utility at the marginal cost prevailing in a competitive market, then economic efficiency ordinarily would be maximized." Exh. 13, page 7.

Mr. Pyrdol found the market-price test to also be consistent with principles of utility regulation. He said there is a "long recognized principle that public utility regulation should seek to simulate competition and thereby enhance, to the extent possible, economic efficiency. [Since] [a]ffiliated coal companies are similar to public utilities, in that they are largely assured of a market for their goods, and are therefore isolated, to a significant degree, from incentives to operate efficiently that exist in competitive markets . . . it is beneficial, from a regulatory perspective, to judge the cost of an inter-affiliate or imprudently entered arm's-length coal supply agreement against competitive market prices for comparable coal." Exh. 13, page 8.

As for the method of determining a market price for a specific coal supply, Mr. Pyrdol said "there are many unique characteristics found in different regional and local coal markets serving different utility power plants; accordingly, the calculation of a market price must consider the particular circumstances of the coal market in question." Exh. 13, page 10. The market price is determined in three steps (*id.* at 11):

(1) Identification of the product market;

(2) Geographical boundaries of the market; and

(3) Selection of transactions to be examined within the product and geographic markets.

1. Product market

"A product market can be defined as a group of goods . . . each of which is readily interchangeable with the others. Since coals can vary widely in quality, the identification of the product market involves identifying acceptable ranges of coal quality characteristics to be included in the market analysis." Exh. 13, page 11. Since the effort here is to establish a market price for coal delivered to the Mitchell plant, the product market for

the Mitchell plant is defined by "looking for coals that can be used as substitutes for the coal presently being used to generate electricity at the Mitchell plant." *Id.* at 12.

2. Geographic market

"The purpose of defining the geographic boundaries to enclose a market is to identify that area within which actual or potential buyers realistically could turn to gain alternative supplies of the product, and within which the suppliers actually could supply the product." Exh. 13, page 12. With respect to the Mitchell plant the geographic market is that which "serves or could serve that plant." *Id.*

There is no hard and fast formula that can be applied to determine the boundaries of geographic markets, but several elements should be considered in determining the market boundaries of a particular generating station: first, the areas from which, in this case, Mitchell obtains coal from non-affiliates; second, areas from which other neighboring generating stations obtain comparable quality coal; and third, examine FOB mine price data and bid solicitations and responses. Exh. 13, pages 13, 14. Here, Mr. Pyrdol thought since there are a "a number of plants located relatively close to Mitchell, 50 miles or even 100 miles should define plants with a similar perspective on the market." *Id.* at 15.

3. Selection of transactions

Several factors must be considered in determining which transactions are to be included in the market-price analysis. "These factors include: transaction duration . . .; vintage of transaction . . .; and size of the transaction." Exh. 13, page 16. "Ideally, only arm's-length transactions that replicate, as closely as possible, the arm's-length contractual alternatives available at the time of the affiliated transaction should be used in the comparison." *Id.*

Economic literature suggests there can be a correlation between the duration of a transaction and prices; that is, "longer transactions appear to result in lower prices, everything else being equal." Exh. 13, page 17. "Since affiliated coal operations are set up to supply the parent utility with captive coal for the long term, or for the life of the mine, one must look at arm's-length transactions of a similar long-term nature for market-price comparison purposes." *Id.* at 18.

Economic theory suggests there is a correlation between the vintage of a contract and its present price; that is, "contracts of an older vintage, i.e., signed at an earlier date, may result in lower prices than newer vintaged contracts, everything else being equal." Exh. 13, pages 18, 19.

Economic theory indicates "there may be a 'volume discount' associated with larger volume contracts." Exh. 13, page 21. "The arm's-length contracts used to calculate a market price should be of a similar size or volume as the arm's-length contractual alternatives available when the captive coal contract was signed." *Id.*

There are two relevant prices available concerning coal sales: FOB mine price, *i.e.*, the price of coal at the mine and FOB power plant, i.e., the price of coal delivered to the plant. Exh. 13, page 22. Since it is "the price that a power plant should expect to pay for a substitute coal if it used that substitute coal rather than the affiliated coal supply" that is to be determined, the "FOB power plant prices should be used in the market price calculation." *Id.* With this in mind it is difficult to use FOB mine prices since adjustments must be made for transportation costs; furthermore, FOB mine prices are generally considered proprietary information in the coal industry and consequently there is a lack of data. *Id.* at 23.

The FOB power plant prices actually paid by other power plants located near the Mitchell plant as reported in Form No. 423 can be used. Exh. 13, page 23.

B. Dr. Kleber's Application of Mr. Pyrdol's Methodology

The annual requirements of the Mitchell generating plant are approximately three and a half million tons of coal. Exh. 15, page 12. A significant percentage of this coal is not affiliate coal but rather is provided by independent procedures. *Id.* The average annual price of independent coal delivered on contract to Mitchell was (*id.*):

	Cost per ton	*Cost per Btu*
In 1980:	$29.05	121.6¢
In 1981:	$32.63	137.9¢

The average annual price of Martinka coal supplied to Mitchell was (*id.* at 11, 12; Exh. 15HH, pages 1, 2):

In 1980:	$44.10	184.9¢
In 1981:	$63.59	268.7¢
In 1982:		206.8¢

The affiliated coal produced at the Martinka mine is a bituminous coal with an average heat content of approximately 11,800 Btu's per pound and an average sulfur content of approximately 1.5%. Exh. 15, page 11. The independent coal being burned at the Mitchell generating plant has somewhat different heat and sulfur contents than the affiliated coal from the Martinka mine. *Id.* at 13. The limitations of Mitchell's boilers require a minimum average Btu content of 11,500 Btu's per pound and a maximum sulfur content of 7.5 pounds of sulfur dioxide per million Btu's. *Id.* at 13. The independent coal being burned at Mitchell is, in Dr. Kleber's view, within the applicable physical and environmental limitations. *Id.* at 14.

Dr. Kleber examined coal purchases by neighboring generating plants in an attempt to identify independent

coal with quality characteristics generally similar to those of the affiliated coal produced at the Martinka mine. Exh. 15, page 14. He looked only at bituminous coal with a heat content greater than 10,000 Btu's per pound. *Id.* In addition, he looked at coal with a sulfur content ranging from 1% to 2% which roughly approximates the sulfur content of the Martinka coal and coal with a sulfur content ranging from 1% to 4% which roughly approximates the sulfur content of the independent coal which can be burned at Mitchell. *Id.*

He identified neighboring plants by examining those within 50 miles of Mitchell (13 coal-fired plants), within 75 miles (7 additional plants), and withir 100 miles (12 additional plants). Exh. 15, pages 14, 15. These plants all obtain coal from Bureau of Mines District Nos. 1-8, and this measure of the geographic market is generally corroborated by AEP's bid solicitation for coal for Mitchell. *Id.* at 15.

Drawing upon information provided monthly to the Department of Energy for individual generating plants in the response filed by electric utilities on Form No. 423, he identified coal with the necessary quality characteristic delivered under contract, excluding transactions of less than one year, to the identified neighboring generating plants. Exh. 15, page 16. In general this information showed (*id.* at 16-19):

Coal With 1-4% Sulfur

Plants Considered	*Year*	*Tons* *	*Number of Plants*	*Average Price* **	*Average Price* ** *without Bruce Mansfield*
Within 50 miles:	1980	14.7	13	119.5(123.2)	
	1981	15.6		134.2(138.4)	
	1982	11.6		149.6(154.2)	
	(9 mos)				
Within 75 miles:	1980	21.3	18	132.6	121.0(124.8)
	1981	21.4		153.3	135.4(139.6)
	1982	16.6		164.1	149.9(154.5)
	(9 mos)				
Within 100 miles:	1980	39.4	26	128.1	121.8(125.6)
	1981	34.4		147.2	135.9(140.1)
	1982	26.7		157.8	148.8(153.4)
	(9 mos)				

* in millions

** weighted average and delivered price in cents per million Btu's () shows adjustment because it has been found that nationwide coal prices reported on Form No. 423 were understated by 3.1%. Exh. 15, page 20.

Plants Considered	*Year*	*Tons* *	*Number of Plants*	*Average Price* **	*Average Price ** without Bruce Mansfield*
		Coal With 1-2% Sulfur			
Within 50 miles:	1980	2.0	8	136.8 (141.0)	
	1981	2.1		148.3 (152.9)	
	1982 (9 mos)	1.5		170.7 (176.0)	
Within 75 miles:	1980	3.9	12	132.8 (136.9)	
	1981	3.6		147.1 (151.7)	
	1982 (9 mos)	2.7		165.7 (170.8)	
Within 100 miles:	1980	13.7	18	121.1 (124.9)	
	1981	11.1		134.5 (138.7)	
	1982 (9 mos)	8.7		144.9 (149.4)	

* in millions

** weighted average and delivered price in cents per million Btu's () shows adjustment because it has been found that nationwide coal prices reported on Form No. 423 were understated by 3.1%. Exh. 15, page 20.

The tabulation of prices without the Bruce Mansfield generating plant being considered was supplied since coal shipments to that plant include high-priced affiliated coal that is currently being contested by the Commission Staff in *Ohio Edison Company*, Docket No. ER82-79-000. Exh. 15, page 18. Although there are 4 plants within 50 miles of Mitchell that received affiliated coal, the relatively small amount of that coal would only change the market price by less than one-half of one percent, and therefore they were not excluded. *Id.*

Comparing the cost of Martinka coal at the Mitchell plant to various average prices, the Martinka coal price exceeded the average prices as follows (Exh. 15, pages 21-22; Exh. 15GG):

Year:	*1980*	*1981*	*1982 (9 mos.)*
	(Dollars per Ton)		
Coal of 1-4% Sulfur - Within 50 miles	14.72	30.83	11.01
Coal of 1-2% Sulfur Within 50 miles:	10.47	27.40	5.86

Using coal with 1-4% sulfur delivered within 50 miles of the Mitchell plant the total overcharge, according to Staff, would be: 1980: $18.6 million; 1981: $28.5 million; and 1982: $22.2 million. Exh. 15, page 21; Tr. 994.

C. OPCO's Criticism of Staff's Market Evidence

1. Respecting Mr. Pyrdol's Methodology

Dr. John H. Landon, Vice President, National Economic Research Associates, said the "premise underlying Mr. Pyrdol's analysis is that it is appropriate to judge the efficiency of a utility's investment in fuel supply and its recoverability in rates by comparing its costs with subsequent market prices at a specific point in time." Exh. 9, pages 5, 6. He thought this treatment "inconsistent both with sound economics and with the manner in which utilities are regulated in other areas of their operations." *Id.* at 6.

Dr. Landon asserts that in "evaluating the prudence of an investment, the economically relevant comparison is between the *expected* value of the resulting stream of costs and benefits *over the life of the asset.* Such a comparison is, by definition, forward looking and should be made using the best forecasts of future market conditions available *at the time the investment is undertaken.*" Exh. 9, page 6. He is of the opinion that it "would be contrary to sound economic principles to discourage utilities from making long-term investments which have a positive present discounted value by establishing a policy of retroactively denying expenses which are in excess of alternative costs in a future short-run period." *Id.*

In Dr. Landon's view the relation between the cost of coal from Martinka and "market" price is an appropriate measure of the benefits to OPCO "if 'market' price is properly determined and the relationship of costs to market price is determined over the appropriate period." Exh. 9, pages 6, 7. "[T]he appropriate period for judging the prudence of a utility investment in mining is the life cycle of the mine as viewed at the time the decision to invest in the facility is made." *Id.* at 7. "A properly determined 'market' price would be based on projected delivered prices for equivalent coal (*e.g.*, sulfur content, ash content, BTU content, grindability, ash fusion temperature, etc.) allowing for differences in the security of supply, length of contract, variability of coal quality, and other contractual provisions which have significant economic value to the company." *Id.* at 7.

Dr. Landon thought the Martinka coal operation should be viewed within a wider context than was done by Mr. Pyrdol. He gave three reasons for this conclusion (Exh. 9, pages 7-9):

(1) "There is not a great deal of difference in the incentives motivating firms to be efficient between affiliate and independent mines if they all have cost plus rate of return or fixed price plus comprehensive escalation contracts. In any of these cases, it is long-run concern for the relations with customers which motivate efficiency rather than an immediate contractual relation between costs and profits."

(2) "It is not proper to view an individual coal supply arrangement outside of the context of all the other such arrangements made by the firm. . . . [I]t is entirely appropriate that utilities put together coal supply arrangements as a portfolio of contracts with differing durations and other terms and for coal from different sources. . . . Inherent in building such a portfolio, however, is the consequence that some types of arrangement with some sources will, ex post, appear more favorable than others at any given point in time."

(3) "Even a broader examination than a utility's coal contracts as a whole may be warranted. It is, after all, the cost of the power flowing from the generator that should be the focus of the utility's concern. . . . For example, paying a premium for fuel that allows a savings in construction costs and/or operating and maintenance expenses often will prove worthwhile."

Dr. Landon does not agree with what he says is a major premise of Mr. Pyrdol, that market price is an appropriate benchmark against which to measure affiliate transactions because it is equal to marginal costs which represent the real resource costs of efficiently operated firms. Exh. 9, page 10. In brief, he thinks this premise is only correct if the market is in long-term equilibrium in which case market price will be equal to the long-run marginal costs of production, and the coal market has not been in a state of long-term equilibrium; consequently, observed prices are not equal to marginal costs. *Id.* at 10-13. Dr. Landon asserts this analysis is important since without "a theory supporting the use of

. . . 'market price' as an appropriate benchmark, there is no basis for using the difference between it and the affiliate coal price as a measure of excessive cost which can be disallowed in setting rates." *Id.* at 13.

Another problem which Dr. Landon stated arises from judging a utility's decision to produce rather than buy from others by comparing current production costs with current market prices is that such a standard "would limit the revenue of utilities to some average 'market' level [and] would increase their business risks and cost of capital." Exh. 9, pages 14, 15.

2. Respecting Market Price Determination

According to Dr. Landon, the "cost of coal supplied to other generating plants in the same geographic area is not a good proxy for what Ohio Power Company would have paid independent vendors for coal deliverable to its Mitchell generating plant" because: (1) "Individual plant characteristics vary over a substantial range and dictate, to a large extent, the relationship between the physical characteristics of coal and the economics of plant operation;" (2) the data available to Staff did not allow for quantification for factors such "as contract vintage, contract duration, delivery schedules and other terms and conditions;" (3) the 50, 75 and 100 mile radius measures used to establish geographic market areas have no particular basis in economics; and (4) the use of delivered coal prices creates an obvious source of error. Exh. 9, pages 16, 17.

Furthermore, the Staff evidence is flawed since it compares "the price of a *specific* transaction between affiliated companies with an *average* of prices of transactions between unaffiliated parties."[1] Exh. 9, page 19.

[1] Mr. Pyrdol, from an economist's point of view, agrees with the use of a range of prices for a comparison, but believes the Commission's Opinion Nos. 133 and 164 specify use of the average price. Tr. 961-62. OPCO believes Opinion No. 133 affirmed a comparison by use of a range of prices. OPCO Initial Brief, pages 170-71.

Mr. Gerald Blackmore, Executive Vice President for Fuel Supply for the American Electric Power Service Corporation, said the "only valid 'market price' comparison in the context used by the Staff would be comparison of 'like' coal from similar mines with similar economic parameters"—the "ultimate test of any 'like' coal would [be whether it would] yield a similar performance in the steam generator." Exh. 4, page 26. Furthermore, he testified "one would need to consider the value to the buyer of the duration and conditions under which such 'like' coal might be obtained." *Id.* at 26, 27.

Mr. Blackmore thought a possible approach is a "marginal" price comparison which should be made where the "marginal mine-mouth price is assumed to equal the cost of coal produced from the last mine opened (marginal mine)." Exh. 4, page 35.

D. Discussion and Conclusions Respecting Staff's Market Evidence

1. Methodology

Any methodology relevant to the question of whether the utility seeks to recover "more from their rate-payers than the price that would have been incurred if a comparable coal supply contract had been made with a non-affiliated supplier" is acceptable. That is the ultimate question the Commission indicated in Opinion No. 133 is to be answered. The methodology described by Mr. Pyrdol would reach a relevant result. However, as discussed hereafter, that methodology was not applied by the Staff in an acceptable manner and the end result of the Staff's implementation has little relevance.

Dr. Landon takes issue with the Staff's use of a market-price approach. In light of the adoption of that approach

by the Commission in Opinion No. 133 the Staff correctly reasoned that a market-price comparison was to be used. What the Commission did not specify is what sort of market price is to be used. For example, the Commission approved consideration of a range of market prices, but it did not rule out consideration of a single weighted average. The Commission made several statements in Opinion No. 133 that support the conclusion that any market price relevant to the question quoted above can be considered. For example, it said that "the reasonableness of the cost of coal purchased from an affiliate should be determined by comparison to the prices of coal available from non-affiliated suppliers"; "[p]rice differentials may also be justified with respect to . . . different market circumstances at the time long-term contract prices were regulated"; and it recognized "the difficulties in identifying comparable prices." 17 FERC at pp. 61,245-46.

These statements are interpreted to mean that even though the end result sought is what price would have been incurred "if a comparable coal supply contract had been made with a non-affiliated supplier" at the time the commitment was made to the affiliated supplier, any type market price that might assist in answering that question can be relied upon. Specifically in this case it is relevant to consider market prices for someone entering the market on a current basis; it is relevant to consider market prices for someone buying from a newly opened mine; and it is relevant to consider current, past, and future market prices under other contracts entered into at the time OPCO committed itself to the Martinka coal. Of course the weight to be given this evidence is the difficult problem, and, as Judge Harfeld said, the full range of relevant evidence must be subject to "a reasoned exercise of judgment and discretion."

When this flexibility is built into the market price approach some of Dr. Landon's objections are answered. In particular his view that the commitment to affiliated

coal must be looked at over the full range of time that commitment is made for is covered by looking at market prices for comparable contracts entered at the same time as the affiliated coal commitment over the full range of time the contracts run. Obviously in deciding if OPCO made a good deal in this case it would be relevant to know how their prices will compare over the full life of their arrangement when compared with an arrangement made by others with non-affiliated suppliers. This doesn't mean that this type evidence must be introduced; only that if it is introduced it would be relevant.

Even though the evidence introduced in this case does not permit of an analysis of how good an arrangement OPCO has for the Martinka coal from the present into the future, that sort of analysis would also be relevant. The fact that a commitment to affiliated coal looked reasonable at the time it was entered into, and was as good an arrangement as was available at that time from non-affiliated coal-suppliers, does not mean that it would be prudent for an affiliated coal supplier arrangement to be continued. If changing conditions would indicate that projected market prices show that continuation of an affiliated coal supplier commitment was not prudent, a discontinuation of the affiliated arrangement might be required.

Mr. Pyrdol agrees with OPCO that the test of whether costs should be allowed in the cost-of-service can't be justified solely by looking at a single point in time. Exh. 13G, page 2. He overcomes that criticism by saying the market standard is to be applied in a continuing fashion into the future. Id. at 3. However, Mr. Pyrdol is not certain as to how the situation would be handled, in Staff's view, when the price of coal from Martinka becomes cheaper than the market price; *i.e.*, will OPCO be allowed to recover from its ratepayers the difference between Martinka coal prices and market prices, just as it would be required to forego recovery of such differ-

ences when Martinka coal is priced higher than the pertinent market price. Id. at 3, 4. Mr. Pyrdol says he has not been presented with such a case but the "starting point for [his] review . . . would probably be that it would be reasonable to charge a market price for affiliate coal, although there may of course be some exceptions." Id. at 4. In any event OPCO's concern that it might be whipsawed between the Commission only allowing it "market price" and the Securities and Exchange Commission only allowing OPCO to pay the actual cost-of-service, with the end result that the rule would be for OPCO to not be able to recover its in-excess-of market costs when that situation occurred, and on the other hand not being able to gain any benefits if the Martinka mine costs should be less than "market price" is real. *See* OPCO Reply Brief, pages 8, 9, 37.

From a theoretical standpoint Mr. Pyrdol's notion of a continuing windfall or penalty as the market conditions change sounds fair. However, such an approach would only be reasonable if regulated entities should be penalized for decisions that turn out bad even though on the basis of the facts as they appeared at the time the decision was made the decision-makers acted reasonably. Such an approach would not be consistent with the overall approach to regulation.

2. Market price

To determine if there are advantages or disadvantages to purchasing the Martinka coal on a short-term basis is an integral part of deciding if there are overall advantages from either the long- or short-term point of view. The record doesn't provide any clue as to what the long-term consequences are of OPCO purchasing coal from the Martinka mine. There is considerable evidence about the short-term situation.

Staff takes the position that the coal contracts considered by Dr. Kleber, even though identified by only the

Btu and sulfur levels and consequently not necessarily capable of being burned at the Mitchell plant without causing problems like those experienced from the McElroy coal, still give a pertinent market price for comparison purposes. Staff argues that the market price for coal used within the pertinent geographic area is determined by Btu and sulfur levels and hence it isn't necessary to know if the coal has other qualities such as would be needed for burning in the Mitchell plant. For example, even if only coal with an ash fusion temperature of about 2700 degrees should be burned in the Mitchell plant, Staff contends the price of such coal would be controlled by what its Btu and sulfur levels are, rather than because it has a particular ash fusion temperature. OPCO says that coal prices are determined by many factors and consideration of market prices by only segregating transactions by Btu and sulfur levels is meaningless.

As discussed hereafter, OPCO is correct. The Staff has not persuasively established a market price for coal under circa 1970 contracts that could be substituted for Martinka coal at the Mitchell plant, and the evidence is persuasive that it makes economic sense for OPCO to use a coal of the quality of that from the Martinka mine even if it is more expensive than the coal used in the past. The Staff failed by not looking beyond the Btu and sulfur levels of the contracts it used, and by not examining in more detail the impact of the years the contracts were entered into, *i.e.*, the contract vintage.

a. Suitable coal for use in the Mitchell plant

Staff argues that in "determining whether Martinka coal is comparable to the coal used in Staff's study, the coal the Mitchell plant was designed to burn should be used, not the coal OPCO uses currently." Staff Reply Brief, page 75. This position is rejected. When, as discussed hereafter, the coal used in the Mitchell plant in the past, which was a coal the Mitchell plant was designed to burn (Exh. 4, pages 15-16), has caused ex-

cessive downtime in the plant, it is meaningless to compare the cost of such coal with what the plant requires to operate economically. There is nothing persuasive in the record to indicate the Mitchell plant can accomplish the same operating results as it is achieving by use of the Martinka coal with a coal of different quality. The Staff's witness Charles McCann, a chemical engineer at the Pittsburgh Energy Technology Center, Department of Energy, testified that he had "no notion of what [coal the Mitchell plant] is currently capable of [operating on]." Tr. 1278. Mr. McCann agreed with the logical statement that "to make an informed judgment of what coal should be burned at the Mitchell plant, one must be familiar with actual operating experience at Mitchell based on different coals used and also [with] a complete evaluation of the boiler's actual operating conditions." Tr. 1323. This is the background OPCO had before deciding to burn the Martinka coal.

The Hall studies done by OPCO in 1976 and 1977 (Exh. 32B, part III, pages 5, 6, 11-14, Appendix D; Exh. 32C, parts V, VI; Exh. 32E, page 3) and the actions of OPCO in relation to Mitchell Unit No. 2 subsequent to that repor are consistent with credible OPCO witnesses stating that coal of an ash fusion temperature of 2700 degrees should be burned in Mitchell Unit No. 2 if the excessive downtime that Unit experienced in past years is to be avoided (Exh. 2, pages 5-7; Exh. 3, pages 40-45; Exh. 4, pages 16-18, 25). For example, in 1980 and 1981 OPCO solicited bids for coal to be used in the Mitchell plant and one of the specifications was an ash fusion temperature of 2700 degrees. Exh. 15DD, 15LL. The ash fusion temperature of the McElroy coal which OPCO believes caused the excessive downtime of Mitchell Unit No. 2 is about 2190 degrees. Exh. 3, page 22.

Furthermore the evidence that the economic consequences of keeping Mitchell Unit No. 2 operating more often than it has in the past justifies paying about $12-18 per ton more for a more suitable coal compared to the McElroy coal is unchallenged. Exh. 3, page 46; *also see* Exh. 4, pages 23-24; Exh. 32E and Exh. 7 thereto; Exh. 32B, part IV; Exh. 32D and Exh. V.b.-15 thereto; and Tr. 577-78, 590-91. Staff and OPCO both agree that the ash fusion temperature of coal bears significantly on unit availability.[2] Staff Initial Brief, page 36. Since the $12-18 per ton would essentially offset any difference the Staff found to exist between the price paid for Martinka coal and Staff's market price, the switch to that quality coal was justified. This still leaves the question as to whether OPCO could have achieved this economic benefit by buying coal of a quality comparable to Martinka coal at a cheaper price.

The Staff evidence by Mr. Schuppin that the AEP system does not need the capacity it gets at Mitchell by improved availability (Exh. 16, page 4) was rebutted by OPCO. Mr. Schuppin in essence says OPCO should keep burning the McElroy quality coal at Mitchell since it can get it cheaper and the fact that Mitchell has excessive downtime isn't important since AEP has more capacity than it needs anyhow. Mr. Schuppin agreed during cross-examination that utilities are able to sell excess electricity, at least sometimes, when they have excess capacity. Hence, it is not possible to conclude that OPCO is merely increasing the Mitchell plant availability so that it can shut in that plant part of the time, or so some other plant on the AEP system can be shut in. The fact that AEP sells 35% of its electricity to other utilities also undermines Mr. Schuppin's thesis (Tr. 567-68), particularly since the "cost of generating power on the AEP system is

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[2] Staff's Reply Brief, pages 81-82, seems to take a different view. In part this is based upon comparing the operation of Mitchell Units 1 and 2. The Staff comparison is not persuasive since Unit 1 has been de-rated to 660 MW and operation at this lower level permits different quality coals to be burned. Exh. 3, page 42; Exh. 3A, pages 6, 7.

considerably lower than [for] some of the surrounding neighbors." Tr. 764.

David H. Williams, Jr., Senior Vice President-Operations, AEPSC, disagreed with Mr. Schuppin's conclusions (Exh. 2G, pages 1, 2):

> [O]ur objective is to generate power at the lowest possible cost on a reliable and continuous basis. Our decisions regarding coal quality at the Mitchell Plant, as well as the other fossil plants on the AEP system, must be based on maintaining reliable operation on a continuous basis. It is one thing for management to decide to shut down capacity that may not be required at a particular time. It is quite another thing for the capacity to be forced out of service due to poor quality coal.... We think it is in our customers' best interests to supply coal that meets the designated unit specifications.

Mr. Williams' statement makes sense.

b. New contract prices versus pre-existing market prices

In analyzing the evidence it is important to make a distinction between "new contract" market prices and "pre-existing contract" market prices. An important distinction is that a purchaser entering the market on a current basis is likely to pay a different price for the same coal that is being bought by others under preexisting contracts. The Staff does not seem to argue that OPCO's purchase of Martinka coal should be judged by what "new contract" purchasers would pay for comparable coal. Tr. 925-27. Rather, Staff seems to assert OPCO should be judged by what is actually being paid for comparable coal by puchasers who entered into applicable purchase agreements at the time OPCO committed itself to using Martinka coal. Id. This approach was expanded by Staff to pertinent contracts at least one year in length on the basis of its conclusion that neither the vintage nor duration of

the contracts significantly influence the prices paid under "pre-existing" contracts in 1980-1982.

In any event it is relevant to know what OPCO would have to pay to buy comparable coal under a new contract. The record includes several documents respecting two bid solicitations for coal to be burned at the Mitchell plant conducted by AEPSC on behalf of OPCO. These documents indicate:

(a) January 16, 1980 socilitation (Exh. 15DD): The specifications for the coal in part were:

	Minimum	*Maximum*	*Normal*
Btu's/Lb.:	11,800		12,000-12,500
Ash Fushion Temperature, Softening Hemispherical in Reducing Atmosphere:	2700°		
Sulfur Content:		1.5%	.8-1.5%

Sixty coal offers were received in response to the solicitation (Exh. 15DD, Schedule 4) but only twenty-two offers met Mitchell specifications (*id.* at Schedule 5). Meetings were later held with three suppliers "meeting plant coal specifications as well as the bid letter requirements" and it was recommended that 50,000 tons/month be purchased at a base price of $29/ton (an additional transportation charge of $4.45/ton was involved), 12,500 Btu's subject to a quality adjustment of $0.35 per 100 Btu's; the specifications in part were: Ash 12% Maximum; Sulfur 1.5% Maximum; Btu 12,500 Minimum; Ash Fusion Temperature, Softening Hemispherical in a Reducing Atmosphere 2800° Minimum.

(b) June 18, 1981, solicitation (Exh. 15LL): The specifications for the coal were similar to those in the January 16, 1980, solicitation *supra*. Part of the papers preceding the solicitation is one titled "Specifications per Plant Engineering" and it shows various specifications for the Mitchell and two other plants. Mitchell's specifications include items not included in the solicitation letter but to

the extent that specifications are shown in the bid letter they are substantially consistent with the Mitchell "Specifications per Plant Engineering." Twenty coals were offered which met the specifications provided in the bid letter. The delivered prices at the Mitchell plant ranged from 139.65¢/MMBtu-210.28¢/MMBtu, or approximately $33-$50/ton.[3]

The 1980 offer of $33.45/ton delivered (the next to lowest offer received) is to be compared with the price of $44.10 per ton paid by OPCO for Martinka coal in 1980; the comparison is not accurate to the extent that the Martinka coal is a circa 11,800 Btu/pound coal whereas the 1980 bid coal was based on 12,500 Btu/pound. In 1981, the solicitation produced offers of delivered prices at the Mitchell plant from 139.65¢/MMBtu-210.28¢/MMBtu. These are to be compared with the price of 268.7¢ paid by OPCO for Martinka coal in 1981. As a matter of perspective, there were particular operating problems at the Martinka mine in 1981 and also its unit costs were affected by a strike during March-June; in 1982 the average price paid for Martinka coal was 206.8¢. Tr. 69-71; Exh. 15V; Exh. 4, page 20; Exh. 5, pages 15-18.

Even though the 1980 and 1981 bid solicitations lead to the conclusion that Martinka quality coal could have been obtained at a cheaper price than was paid by OPCO for the Martinka coal, this conclusion is tempered by the fact that the 1980 contract offer was for a minimum of 3 years and the bid may have been made at a time when the coal market was soft (Tr. 644). The 1981 solicitation was for contracts from 1 to 15 years in length, and the market again may have been soft. Exh. 8, page 8.

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[3] The price per ton is computed by the formula in Exh. 15A and assuming coal with 11,800 Btu which is about what the Martinka coal was in 1980-82. Exh. 15P, Schedules 1, 2 at pages 12, 13 respectively; Exh. 15KK, page 12.

If the Staff's argument that neither vintage, duration, or quantity of a coal contract affects the price is accepted, it would be expected that the prices offered in 1980 and 1981 would approximate the averages Dr. Kleber arrived at in his analysis. This expectation would only hold true if comparable coals, in a price sense, are being considered. The average of the 22 offers made in 1980 was $1.6/MMBtu and of the 20 offers made in 1981 the average was $1.8/MMBtu.[4] Assuming for gross comparison purposes only that the coals were 12,500 Btu, these averages convert to $40 and $45/ton. *See* Exh. 15A for the formula used. Dr. Kleber's weighted averages for 1-4% coal in 1980 and 1981 were $1.2 and $1.4/MMBtu for plants within 50 miles of Mitchell. This comparison raises doubts as to Dr. Kleber's conclusion that his average prices are for coal comparable, in a price sense, to Martinka. Dr. Kleber's averages for 1-2% sulfur coal were $1.4 and $1.5/MMBtu for 1980 and 1981 for plants within 50 miles of Mitchell but the difference from the bid averages are still enough to cause one to question the assumptions made by Dr. Kleber; and *a fortiori* when the soft coal markets of 1980, 1981 are considered. On the other hand the offered prices are just that and might have been lower if further negotiations had been carried out.

Another interesting comparison is of the 1980, 1981 bid averages with what OPCO paid for Martinka coal in those years: about $40 for the bid average in 1980 compared to a Martinka price of $44.10 and about $45 for the bid average in 1981 compared to a Martinka price of about $48 in 1982—the 1981 Martinka price is disregarded because of the unusual factors involved in that year.

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[4] The information on the bids is found on Exh. 15DD and 15LL. The averages are not weighted averages, but rather are averages of price numbers found in the exhibits rounded off to the nearest tenth, that is, for example, 139.65¢/MMBtu was rounded to $1.4.

OPCO witness Gerald Blackmore, Executive Vice President for Fuel Supply, AEPSC, suggested that the price of coal from the Martinka mine should be compared to the marginal mine-mouth price, that is the cost of coal produced from the last mine opened. Exh. 4, page 35. The comparison which Mr. Blackmore said would do this showed prices quite similar to the current Martinka price. Id. at 36, 37. Mr. Pyrdol criticized this suggestion as being one that "would require ratepayers to perpetually pay the price of investing in a new coal mine and to perpetually enter the market anew." Exh. 13G, page 12. Mr. Pyrdol said the Staff's comparison is preferable—it focuses "on independent, arm's length coal contracts being signed at the time of the captive contract and then [looks] at the present day prices of these contracts to establish a market price for the captive coal." Id. at 13. According to Mr. Pyrdol this tells "what Ohio Power would likely be paying today if it had chosen an independent, arm's length contract(s), rather than the captive mine." Id. at 13.

c. Coal purchase transactions suitable for market analysis

Mr. Pyrdol and Dr. Landon agree on a fundamental criterion for market prices. They have to be prices for coal "that can be used as substitutes for the coal presently being used to generate electricity at the Mitchell plant." Exh. 13, page 12; Exh. 9, page 7. Even though Dr. Kleber sponsored some evidence designed to infer the Mitchell Unit No. 2 could efficiently burn coal with different qualities than are found in the Martinka coal, the preponderance of the evidence, as discussed in a., above, is to the contrary.[5]

[5] Dr. Kleber testified that flexibility in the type of coals that can be burned at Mitchell is evidenced by the fact that past purchase orders have specified ash fusion temperatures of 2500° and 2600° compared to current specifications of 2700°; two purchase orders specify a Hardgrove Grindability Index at 80-90 when the Mitchell plant specification is an upper-limit of 80; whereas the boiler specifications for Mitchell call for a maximum ash content of 15% and a maximum sodium oxide content of .75%, a washed sample of Martinka coal in April 1981, exceeded these numbers, and the average monthly ash content of Martinka coal exceeded 16% for a number of months in 1980-82. Exh. 15HH, pages 5-7.

(1) Btu and sulfur levels as price determinants

The Staff's basic position is that even if coal at Mitchell should be comparable to the Martinka coal in a physical sense, the only important price determinants are the Btu and sulfur contents. Exh. 15RR, pages 8, 9; Exh. 13J, pages 2-3. To substantiate this conclusion Dr. Kleber recalculated market prices for coals used in plants with dry bottom boilers and for coals with high volatility and found the market prices differed only slightly from the market prices for all plants within 50 miles of Mitchell. Exh. 15RR at 9.

Dr. Kleber noted that the Mitchell generating plant consists of two units, each with a dry bottom boiler. Exh. 15HH, page 3. Because of that he examined the neighboring plants he used to see which had dry bottom boilers and found that if his market-price analysis for the first 9 months of 1982 had been limited to those plants with respect to coal with 1-2% sulfur and 1-4% sulfur there was very little difference from his initial calculations. Id. at 3, 4; Exh. 15QQ, pages 5, 6.

To give weight to Dr. Kleber's calculations it must be assumed that *all* dry bottom boilers of neighboring generating plants were burning Martinka quality coal. There is some basis for this assumption in that Mr. Doherty on behalf of OPCO identified the basic problem with the McElroy coal at Mitchell was that it was suitable for wet bottom boilers. Mr. Doherty said that wet bottom and dry bottom boilers require coal with different ash fusion temperatures. Exh. 3, page 9. However, there is too much uncertainty as to whether the situations at the neighbor-

ing plants are such that they have been using Martinka quality coal. It could be that at least some of the plants are using McElroy quality coal and having problems similar to those that Mitchell has had, or that for some reason their dry bottom boilers don't require coal with the same ash fusion temperatures as Mitchell requires. *See* Exh. 3, page 7. Mr. Doherty said he was unable to correlate coals used at other plants with the needs of the Mitchell plant since he did "not know the detail design and operating experience that those units have experienced." Exh. 3A, page 8. The obvious way to resolve uncertainties would be to find out what the exact specifications of the coal were that was burned in these other dry bottom boilers. Staff did not do this. Tr. 1022, 1058-59, 1142-43. Absent confirmation of a connection between what the neighboring plants were paying for coal with what was paid for Martinka coal, Dr. Kleber's study is not persuasive of the conclusion he reaches.

There is an inconsistency between the positions taken by Staff witnesses Pyrdol and Kleber. Mr. Pyrdol was of the opinion that a lengthy list of factors (Exh. 9C) could influence the price a buyer would be willing to pay for coal. Tr. 799-801. If this is true, and other witnesses also thought factors other than Btu and sulfur could influence the prices paid (Exh. 4, pages 26, 27; Exh. 8, pages 4, 9-10; Tr. 620-21, 629, 649-53; Exh. 9, page 7), it is not possible to say that contracts used as showing comparable prices for Martinka coal should not be examined to see if some of these other factors did not cause a significant change in the price. The empirical evidence supporting Dr. Landon's conclusion that these other factors can be significant is the way the prices of coal with about the same Btu and sulfur varied in the 19 contracts Mr. Pyrdol looked at in his study of the effects of vintage. For example in 1973 the two contracts plotted by Mr. Pyrdol were about 112¢/MMBtu and 148¢/MMBtu, and a even greater spread occurred in 1980 (102-175). Exh. 13H,

page 1. The immediate question posed is why there should be such a spread in price for coals of similar Btu and sulfur content if those are the only significant price determinants. When Dr. Landon plotted a larger number of contracts with comparable Btu and sulfur contents for coal delivered within 50, 75 and 100 miles of the Mitchell plant the variations on a month-by-month basis are generally large—a 30% or so variation being quite common.[6] Exh. 9M.

Staff's conclusion is rejected. Something more than a mere segregation of contracts by Btu and sulfur content is required to arrive at an average market price for coal of the quality of that from the Martinka mine based on long-term contracts. Therefore, there is no credible long-term market price for the Martinka quality coal in the record.

(2) Vintage, duration and quantity aspects of selected contracts

Notwithstanding that Mr. Pyrdol thinks contracts of the same vintage as the acquisition of the Marinka mine by Ohio Power should be considered, he recognized that there might not be enough vintage contracts available to

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[6] Dr. Landon plotted the monthly prices for transactions within Dr. Kleber's 50, 75, and 100 mile areas and found wide variations within the months for the years 1980 through 1982. Exh. 9H, pages 16-17. He thought there were a number of reasons for the diversity (*id.* at 17-19): (1) differences in coal qualities other than Btu and sulfur, (2) differences among plant locations, (3) differences in the vintage of contracts, duration of contracts, and quantities of coal obligated, and (4) differences in specific contract conditions.

Dr. Kleber responded to Dr. Landon's studies. Exh. 15RR. He compared the monthly and annual average price for Martinka coal with the monthly price entries Dr. Landon plotted and found that the Martinka price was the highest priced coal in the market region in 29 out of the 36 months plotted, and either the second or third highest price in 5 out of the other 7 months. Id. at 1. Dr. Kleber also stated that the fact that Dr. Landon plotted unweighted prices detracted from the meaningfulness of the study. Id. at 1.

make a meaningful analysis and, therefore, contracts of different vintage may have to be used "with attention given to the possible effects different vintages may have on the market price calculation." Exh. 13G, page 13. In fact, of the contracts included in Dr. Kleber's study, over 75% are contracts entered or renegotiated into after the time of the initial development of the Martinka mine. Exh. 15, page 15.

The Staff made an analysis of "the relationship between contract vintages and prices for plants included in Staff witness Kleber's market price calculation." Exh. 13G, page 14. By vintage Mr. Pyrdol meant the time period in which a contract was signed or a definite commitment was made to a relationship. Tr. 797. Based on that analysis Mr. Pyrdol concluded "that using contracts of different vintages does not have any consistent, discernible effect on the market price calculation for coal coming from the Martinka mine." Exh. 13G, page 15. A similar analysis showed that there is "no meaningful relationship between either the length of the contract or its size, and current prices." Id. at 15. Mr. Pyrdol used contracts for coal with 1-2% sulfur delivered to plants used in Dr. Kleber's market price analysis; the data respecting those contracts came from an investigation of electric utility fuel purchasing practices, Docket No. IN79-6. Id. at 15. He based his conclusions on various graphs (Exh. 13H) and to substantiate his conclusions the Staff requested the Energy Information Administration (EIA) to statistically analyze the data. Id. at 16. EIA concluded there was no significant relationship between coal price and vintage, size, or duration. Id. at 16.

Dr. Landon took issue with Mr. Pyrdol's conclusions. In essence he says the wide fluctuation in prices in contracts signed in any particular year makes it impossible to conclude whether or not the year a contract is signed influenced the price agreed upon. Exh. 9D, pages 2, 3; Exh. 9H, page 2. In other words, where the 1981 price

paid for coal contracted for in 1974 ranges from about 129§/MMBtu to 172§/MMBtu, it isn't logical to reach any conclusion as to how important the fact is that the contracts were negotiated in 1974. This reasoning is persuasive. It may well be that the fact the contract was negotiated in 1974 was very important, but before this could be ascertained some explanation would have to be found for why there is such a wide variation in the prices for contracts negotiated in the same year. Looking at the graphs for contract size and contract duration plotted against price (Exh. 13H) similar variations occur which make it illogical to assume that the plots show any relationship between price and these factors. But again, the plots don't prove there is no relationship.

In brief the graphs are consistent with the conclusions Mr. Pyrdol makes about no relationship being shown between these various factors and price, but they do not support a conclusion that no relationship in fact exists. Whether there is such a relationship would require a more extensive analysis than was done by Mr. Pyrdol.

Dr. Landon had other criticisms of Mr. Pyrdol's analysis respecting vintage, size and duration of contracts in relation to the 1981 coal prices under those contracts. In summary the criticisms were (Exh. 9H, pages 4-6):

(a) The majority of the contract summaries relied upon by Mr. Pyrdol in making his analysis did not report the average price paid for coal delivered to the designated plants; instead, they give a range of prices and Mr. Pyrdol simply averaged the high and low prices paid for use in his analysis.

(b) Sulfur and Btu content were frequently given only in broad ranges, and in such instances Mr. Pyrdol simply averaged the high and low values.

(c) The data used in Mr. Pyrdol's analysis is not representative of the contracts underlying the transaction prices averaged by Dr. Kleber. Mr. Pyrdol used 19 con-

tracts whereas Dr. Kleber relied upon more than 100 contracts.

(d) Various errors in taking the data from the data base.

Using the same basic data, but corrected as he thinks it should be, Dr. Landon analyzed the data and concluded that with the changes he made there was a complete reversal of the conclusions which had been reached by Mr. Pyrdol. Namely, "[i]nstead of finding no significant relationship between transaction price and the date, duration and size of contracts . . . [Dr. Landon concluded] all these factors [do] have a statistically significant relation to the delivered prices." Exh. 9H, page 8. Dr. Landon also made a study based on a larger number of contracts and found there are relationships between price and vintage, price and contract duration, and price and contract size. His study is discussed in subsection (3), *infra*.

In response to Dr. Landon's criticisms, Mr. Pyrdol testified as to why the use of the average of prices for Btu and sulfur did not impair his conclusions (Exh. 13J, pages 5-6) and why his data base was appropriate (Exh. 13J, pages 4, 7-11). Mr. Pyrdol accepted some of Dr. Landon's criticisms and ran another regression analysis which he said did not alter his conclusions. Exh. 13J, page 11.

Respecting Dr. Landon's regression analysis of the 19 contracts data base relied upon by Mr. Pyrdol, which Dr. Landon asserts shows a significant relation between delivered prices and vintage, duration and contract size, Mr. Pyrdol said these conclusions were only reached after Dr. Landon eliminated four of the nineteen contracts. Exh. 13J, page 11; Tr. 1459. Mr. Pyrdol did not think two of these contracts should have been eliminated. Exh. 13J, page 12.

Dr. Landon explained why he excluded the four contracts (Tr. 1500) but even if the exclusions are considered proper, when the graph for vintage and price prepared by Mr. Pyrdol (Exh. 13H) is examined with those four contracts eliminated, the variations in price are enough to make one doubtful of any conclusions drawn from such data. Furthermore, the total number of plots on the graphs would be reduced from 19 to 15 and this seems like a very small number for drawing any conclusions. Also Dr. Landon used the average numbers which he criticizes Mr. Pyrdol for using. Tr. 1501. Finally, Mr. Pyrdol's testimony that certain of the plots should not have been removed is sensible. Consequently, the study made by Dr. Landon of Mr. Pyrdol's 19 contracts is no more persuasive of any definite conclusions than is Mr. Pyrdol's study.

There is persuasive evidence in the record that it can be very important to examine the particular year a contract is negotiated. Mr. William Renton, an independent marketing and sales consultant to the coal industry, who has participated in the coal marketplace for many years gave detailed testimony as to how the years of a soft or tight (demand exceeds supply) coal market effect the prices negotiated for coal. Exh. 8, pages 5-8; Tr. 630-32, 639-48, 651-52. These are not assertions made on the basis of some sort of statistical analysis. These are assertions made on the basis of having been a participant in the coal marketplace over a span of years. Mr. Renton's testimony is persuasive that it is a mistake to try to arrive at what the average market price was for coal purchased at about the time the Martinka contract was entered into without looking carefully at the vintage of the putative comparable contracts relied upon and the state of the market at the time the putative comparable contracts were negotiated.

The large fluctuations in coal production during the period 1967-1981 (Exh. 9A) are consistent with this conclusion; it would be expected that during the years where production fell that a reduction in demand was the cause and that at such times a surplus of coal was

available and the sale prices would be less. Mr. Pyrdol observed that older contracts negotiated during tight coal markets may lead to higher prices than more recent contracts negotiated during soft coal markets. Exh. 13, pages 19, 20.

(3) Dr. Landon's analysis of contracts

Dr. Landon testified that he did an analysis of as complete a set of contract information as possible for the thirty-one plants in Dr. Kleber's analysis. Exh. 9H, page 9. In addition to the information used by Dr. Kleber, data were collected on "moisture content, ash content, mine type (surface or deep), mode of transportation, transportation distance and contract specifications for sulfur, ash, moisture and Btu content as well as the delivered specifications used by Mr. Pyrdol." Id. Data were not available as to ash fusion temperature. Id. at 21. The contracts selected were those identified by Dr. Kleber plus those for the three additional plants Dr. Landon had recommended be added to the market. Id. at 9. Eliminated from the data base were those contracts "which did not meet the sulfur and/or Btu criteria used by Dr. Kleber in his transactions analysis." Id. at 10.

Instead of analyzing 19 contracts for 12 plants as used by Mr. Pyrdol, he said he used data from over 200 contracts covering deliveries to 26 of the 31 plants in Dr. Kleber's analysis. Exh. 9H, page 10. Furthermore, data were collected for the years 1979, 1980, and 1981, instead of for only 1981, a strike year. Id. His conclusions from the data are (*id.*):

(a) The price of coal delivered in 1979, 1980 and 1981 appears to be lowest for contracts entered into in the late 1950s and early 1960s.

(b) The price rises sharply for contracts entered into in the late 1960s and is still higher for contracts entered into in the early 1970s.

(c) Prices fall for deliveries pursuant to contracts entered into in 1975 or 1976 and then rise again but not always reaching the levels reached in the early 1970s.

(d) The price of coal appears to be lowest for contracts covering relatively small quantities of coal.

(e) Coal from underground mines tends to be more expensive than coal from surface mines.

(f) Longer term contracts are associated with higher delivered prices, at least in their earlier years.

Dr. Landon did a statistical analysis of this same data and found "statistically significant relationships between delivered prices and the date the contract was signed, the type of mine (underground or surface), the quantity of coal delivered, the duration of the contract and the year for which price is observed." Exh. 9H, page 15.

Mr. Pyrdol testified that Dr. Landon only used 48 contracts in one statistical analysis, and 24 in another. Exh. 13J, page 12. Also the data base contains a number of duplications. Id. at 13. Flaws in the data base, in Mr. Pyrdol's opinion, make the conclusions drawn by Dr. Landon unreliable. Id. at 13. Furthermore, even if it is assumed Dr. Landon is correct, the relationship between contract vintage and price merely supports the Staff determination that the Martinka prices were higher than the average market prices since many of the contracts used by Dr. Kleber were later than OPCO's commitment to the Martinka mine which means that Dr. Kleber averaged in contracts with higher prices by virtue of the vintage. Id. at 16.

As to this final point, Dr. Landon said that Mr. Pyrdol was not reading his exhibits correctly. His exhibits show "a negative relationship between price and contracts signed in [1979 and 1980]. Therefore, [Mr. Pyrdol's] conclusion that [Dr. Landon's] analysis shows that re-

cent contracts are associated with higher prices is inaccurate." Tr. 1513-14. Mr. Pyrdol gave very technical testimony as to why he disagreed with Dr. Landon. Tr. 151[illegible] 26. The testimony of Dr. Landon and Mr. Pyrdol on which conclusions can be made is not persuasive one way or other as to whether contracts signed in 1979 and 1980 were reflecting lower prices. Essentially what the record has is the opinion of two experts without a cogent explanation of those opinions which can be weighed by a lay person. There is no reason to believe one expert is correct and the other is incorrect.

Dr. Kleber takes issue with Dr. Landon's data base. Exh. 15RR, page 2. Instead of there being over 200 contracts covering deliveries to 21 of the 31 plants within 100 miles of Mitchell, the Staff found only 118 contracts for 26 of the 31 plants in the market area, and within this 118 number are some contracts covering supply to several different plants, and 22 contracts for coal outside the sulfur specification in Staff's market price analysis. Id.

As for Dr. Landon's conclusions on the relationship between contract vintage and contract prices, Dr. Kleber notes that Dr. Landon's study, where captive coal and contracts that only show a range of prices are included in the data base, shows the contracts signed in 1971 had the highest prices, but that the other study, where captive coal and contracts where only the range of prices is known are eliminated, has no consistent relationship between contract vintage and prices. Exh. 15RR, pages 5, 6.

Dr. Kleber did a study of his own data for the year 1981 and found the coal from underground mines in 1981 was less expensive than coal delivered from strip mines. Exh. 15RR, page 6. He says that Dr. Landon did not consider the amount of coal coming from the mines in his study. Id.

As to Dr. Landon's study on prices vis-a-vis contract duration, Dr. Kleber opines that the data Dr. Landon ended up with is confusing. Exh. 15RR, page 7.

It is difficult to weigh the conflicting opinions of Drs. Landon and Kleber and Mr. Pyrdol on the value of Dr. Landon's study. Since Dr. Landon's conclusions concerning the importance of contract vintage on prices are consistent with the real world as testified to by Mr. Renton, they are viewed in a positive light. However, if these conclusions had to be based on Dr. Landon's study, a closer analysis of the arguments pro and con would have to be made. This is not necessary since the persuasive evidence of Mr. Renton overrides any of the statistical analyses introduced into the record.

(4) Miscellaneous considerations

Dr. Landon has several relatively minor criticisms of Staff's choice of transactions, but, even accepting these criticisms, the difference in prices between those of the selected transactions and the Martinka price is substantial.

In summary his criticisms are:

(a) Inclusion of 13 mine-month plants (Exh. 9D, page 3): Dr. Landon argues that these prices are too low since there is no transportation cost as there would be if the coal was used at Mitchell.

(b) If the 100 miles market were expanded slightly it would include 3 additional plants and give a more realistic market (Exh. 9D, page 3): Dr. Landon states it would take a significant expansion beyond these 3 additional plants to include other additional plants and therefore the expansion he suggests gets to "a natural break in the chain of substitution." Id.

(c) Surface-mined coal should be excluded (Exh. 9D, page 3): Dr. Landon notes that even though generating

plants will perform equally well using deep or surface-mined coal if it is comparable in all respects, the market appears to distinguish between the two with prices "paid for deer-mined coal appear[ing] to be consistently higher." Id. at 4.

Dr. Landon calculated the changes in average prices as calculated by Dr. Kleber if his changes were made (Exh. 9F):

	Kleber			*Landon*		
	(cents per million Btu)					
1-4% Sulfur	*1980*	*1981*	*1982***	*1980*	*1981*	*1982***
50 miles market:	119.5	134.2	151.0	127.4	142.9	158.6
100 miles market:	121.8	135.9	149.3	143.0	149.0	163.9

** Dr. Landon's exhibit shows 1982 on a quarterly basis; the numbers used for 1982 above are the average of those shown for each quarter.

In short, even though Dr. Landon would calculate somewhat higher numbers there is still a wide margin between these average prices and those paid for the Martinka coal in 1980 (184.9), 1981 (268.7) and 1982 (206.8).

Dr. Kleber took issue with the criticisms and testified that even if the criticisms were correct the results would only slightly differ from these earlier results. Exh. 15RR, pages 1-5. Since the Staff's market prices are rejected on fundamental grounds it is not necessary to decide on what refinements, if any, would be made in market prices if they had been found otherwise acceptable.

Dr. Landon was critical of Dr. Kleber's study in that the prices used were those of coal delivered at locations other than Mitchell. The logical assumption can be made that the transportation costs for delivery to Mitchell would be something different. Dr. Kleber says this is a minor matter since transportation costs in general are only in the 9% range of the total price. Exh. 15RR, page 10. It might also be assumed that adjustments in transportation costs might wash out—those from certain mines would be more to Mitchell *vis-a-vis* the plant the coal was actually delivered to and vice versa. Id. at 11. This is a nice premise to start with but before anyone should be penalized such as Staff proposes here, something more than bare assumptions are needed. A 9% element in price is a significant factor, and some sort of study would have to be made before the prices of coal delivered to locations other than Mitchell could be equated with deliveries to Mitchell. Merely comparing what the market price might be with and without mine-mouth mines included is not a convincing study on this point. In the mine-mouth study it would be expected the transportation costs to Mitchell would be greater. Yet Staff's study showed that by excluding 8 mine-mouth plants in some years the average price relied upon by Staff went up and in one year it went down. Id. at 10. It is difficult to draw any conclusions from that comparison, except to say that something other than transportation costs has caused the difference. The fact that Staff relied on plants within 50 miles of the Mitchell plant in reaching its ultimate conclusions reduces the significance of this element; nonetheless it required a closer look than it received.

Dr. Kleber analyzed what he viewed as overcharges both from the perspective of 1-2% sulfur coal and 1-4%, with the lower sulfur coal being considerably more expensive *vis-a-vis* the Martinka coal and therefore reflecting, in Dr. Kleber's view, a smaller overcharge. The evidence as to the importance of the low sulfur coal for the Mitchell plant is not as complete as is the evidence showing the need for the high ash fusion temperature coal. Nonetheless the evidence shows that OPCO tries to burn 100% of the Martinka coal in Unit 2 at the Mitchell plant and that the Martinka coal has about 1.5% sulfur content. Exh. 3, page 43; Exh. 24; Tr. 176-79. Dr. Kleber testified that he decided upon the 4% level be-

cause of environmental requirements, but, in any event, the fact the Mitchell plant was acquiring coal with 4% sulfur content indicates it is operating with coal with that sulfur content. Tr. 1093. Since the overall analysis of Dr. Kleber is rejected on fundamental grounds it isn't necessary to decide whether the 1-2% or 1-4% sulfur coal would be the proper comparison.

OPCO argues that any comparison of Martinka prices with a calculated market price should be on the basis of a range of market price. OPCO Initial Brief, pages 169-71. OPCO's point is that otherwise it would be penalized on the basis of forced Martinka prices which in many cases were lower than those found in the market place between unrelated buyers and sellers. Other than to note that this argument has a persuasive ring to it, no further analysis is made since Staff's single market price is rejected.

The Municipals argue that even though Staff only seeks refunds for the year 1982 that refunds should also be made for the years 1980 and 1981. Muncipals Initial Brief, pages 72-77. Since no refunds are necessary this position need not be explored. However, any consideration of the year 1981 would have to take into account the unusual operational and strike factors that caused unusually high prices for Martinka coal in 1981.

The Municipals also argue that the 3.1% upward adjustment Dr. Kleber made in his market prices because the data came from Form 423 should not have been made and Dr. Kleber in essence said so in his testimony. Muncipals Initial Brief, pages 54-59. Dr. Kleber's testimony is not viewed as reneging on the adjustment he made, but rather to indicate he thinks it puts his calculated market prices on the conservative side. Tr. 1126, 1157. In any event this argument need not be pursued further since no refunds are necessary.

3. Conclusions

The Staff did not accomplish what it set out to do. Namely, it did not establish prices for coal "that can be used as substitutes for the coal presently being used to generate electricity at the Mitchell plant" by focusing "on independent, arm's length coal contracts being signed at the time of the captive contract and then [looking] at the present day prices of these contracts to establish a market price for the captive coal." Exh. 13, pages 12, 13. It focused on contracts in which prices did not necessarily take into account qualities found in the Martinka coal.

There is credible evidence of market prices for coal of comparable quality to Martinka coal for the years 1980 and 1981. Although they are only offered prices, the responses to the 1980, 1981 bid solicitations are the best evidence as to how the market place viewed Martinka quality coal. A comparison on the basis of an average of the bids, rather than with the lowest bids, gives a reasonable view of the market price in 1980 and 1981.

When the Martinka prices for 1980 and 1982 are compared to the average 1980 and 1981 prices reflected in the bid solicitations put out by AEPSC the Martinka prices do not look too bad. Subsection 2.b., *supra*. They are somewhat higher but this might be attributable to the soft market in 1980 and 1981 instead of any unreasonableness in the Martinka prices. This seems to be true since the unrebutted evidence is that OPCO was prudent in acquiring rights to the Martinka coal (Exh. 1, pages 4-6, 8-9), and that the Martinka mine has been efficiently developed and operated (Exh. 1, page 10; Exh. 4, pages 19-21; Exh. 5, pages 6, 7, 12, 13; Tr. 386,390).

From the vantage point of viewing the evidence and possible evidence after the hearing is over, it appears that there was relevant evidence of the market price of Martinka quality coal under "pre-existing contracts" which would result in a better feel for how good a deal

OPCO has in the Martinka mine compared to the deals others have been able to make for comparable coal over the years—for example, it would be enlightening to know what plants in the vicinity of the Mitchell plant were paying for coal with an ash fusion temperature of 2700 degrees, or what OPCO is paying for coal at the other plants which it says are similar to the Mitchell plant even if they rely on coals distant from Mitchell (Tr. 524). This leads to the next part of this decision and a discussion of the burden of proof.

VI. Burden of Proof

As discussed in Part IV, no one has established that OPCO's purchase of Martinka coal from its subsidiary places it in any worse position than it would have occupied if it had made a similar long-term arrangement for comparable coal circa 1972 with a non-affiliated coal supplier. Most of the evidence has been directed to showing that Staff's presentation wasn't relevant. However, from the evidence available, it appears that OPCO may have paid somewhat more for Martinka quality coal in 1980 and 1981 than it could have purchased it for from others albeit the offers of sale made in 1980 and 1981 were for shorter periods of time. On the other hand, it appears that further efficiencies in the operation of the Martinka mine plus more favorable transportation terms will make the Martinka prices more attractive in the future.

From a legal standpoint the question posed by these factual determinations is who has what burden of proof relative to the claim of excessive costs in the OPCO cost-of-service, and has the burden been carried.

The Staff argues that OPCO has the burden of showing that the proposed rates are just and reasonable. Staff Initial Brief, pages 5-8. The Staff buttresses its position by citations to cases holding that a burden is on a company to justify the fairness of contracts with affiliates. Id. OPCO takes the position that the burden is on those

challenging the prices paid for Martinka coal to show by clear and convincing evidence that the costs were not prudently incurred. OPCO Initial Brief, pages 12-14.

OPCO relies upon language found in Commission Opinion No. 731, 53 FPC 1691, 1703 (1975), which was adopted by Judge Harfeld in the Initial Decision of January 25, 1980. Although that decision became moot because of a settlement, Judge Harfeld recited the position he had taken in his later Initial Decision of November 28, 1980 (13 FERC at p. 65,169) which later decision was approved by the Commission in Opinion No. 133. See *the* discussion at III.C, *supra*.

Notwithstanding the Commission's approval of Judge Harfeld's decision of November 28, 1980, and the recital in that decision that the "Staff or any other challenger bore the burden of proving that the Company's costs were unreasonable," this recital was *dicta*. Judge Harfeld made his decision on the basis of affirmative evidence, not on the basis of a party failing to carry a burden of proof. *See* 13 FERC at p. 65,174. Hence, it isn't clear that the Commission intended in Opinion No. 133 to adopt Judge Herfeld's *dicta*.

There are Commission and court precedents that apply. In *Anaheim, Riverside, etc. v. F.E.R.C.*, 669 F.2d 700, 809 (D.C. Cir. 1981) the court said:

> The Federal Power Act imposes on the Company the "burden of proof to show that the increased rate of charge is just and reasonable." 16 U.S.C. § 824(e). Edison relies on Supreme Court precedent for the proposition that a utility's costs are presumed to be prudently incurred. *See Missouri ex rel. Southwestern Bell Telephone Co. v. Missouri Pub. Serv. Comm.*, 262 U.S. 276, 289 n.1 (1923). However, the presumption does not survive "a showing of inefficiency or improvidence." *West Ohio Gas Co. v. Public Utilities Comm.*, 294 U.S. 63, 55 S.Ct.

316, 79 L.Ed. 761 (1935); see 1 A.L.G. Priest, Principles of Public Utility Regulation 50-51 (1969). As the Commission has explained, "utilities seeking a rate increase are not required to demonstrate in their cases-in-chief that all expenditures were prudent. . . . However, where some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent." Opinion No. 86, *Minnesota Power & Light Co.*, [11 FERC ¶ 61,312 at p. 61,645]. (Footnotes omitted.)

Here the Staff created a serious doubt as to the prudence of the prices paid for the Martinka coal; OPCO has convincingly erased that doubt but did this primarily by attacking the Staff's presentation rather than by an affirmative showing of prudence. OPCO put in some evidence going beyond merely responding to Staff's evidence, but there is undoubtedly additional evidence that would give a better picture as to how the Martinka prices compare with prices for comparable coal. Therefore, the question becomes whether OPCO has failed in carrying a burden of proof by not coming forward with additional evidence.

Considering the presumption that a utility's costs are prudently incurred, the rule cited by Judge Harfeld about the burden being on challengers, and the evidence that (a) the rights to the Martinka coal were prudently acquired, (b) the Martinka mine has been efficiently operated, (c) the prices of Martinka coal have shown a trend downward in constant dollars (Exh. 4., page 20), (d) that prices from newly developed mines wouldn't be much different than the cost of Martinka coal (Exh. 4, pages 35-37), (e) the projected price for Martinka coal discussed below, and (f) the market-price study performed by OPCO discussed below, whatever legal requirement is involved in the *Anaheim* decision about "dispelling these doubts and proving the questioned expenditure to have been prudent" has been satisfied by OPCO.

OPCO made a market-price study by identifying what was considered to be mines within 75 miles of the Mitchell plant which had coal comparable to the Martinka coal. Exh. 4, page 33. When the delivered prices of that coal (Tr. 514-15) are compared for the years 1980-1982 (Exh. 4K) with the Martinka coal price (listed as Southern Ohio on Exh. 4K), Martinka prices seem reasonable. The coal considered in the OPCO study was in the 1-2% surfur range; the following is a comparison of the weighted averages of the delivered prices shown on Exh. 4K with the price on Exh. 4K for Martinka coal, and the amounts Staff thinks OPCO overpaid for 1.2% coal:

Year	*Staff View of Overpayment (Exh. 15, pages 21-22; Exh. 15GG*	*Exh. 4K price for Martinka coal*	*Exh. 4K price on weighted average basis for other coal*	*Exh. 4K price spread*
1980	$10.47/ton	$44.10/ton	$37.21	$ 6.89
1981	$27.40/ton	$61.83/ton	$44.01	$17.82
1982	$ 5.86/ton	$49.09/ton	$55.17	—$ 6.08

Dr. Kleber took issue with OPCO witness Blackmore as to the seams from which coal burned in Mitchell must come. The OPCO market-price study was premised on the belief that only certain seams produced the quality coal needed at the Mitchell plant. Exh. 4, page 34, First, Dr. Kleber noted that coal offered in response to the 1980, 1981 bid solicitations for coal for the Mitchell plant come from a number of seams other than those identified by Mr. Blackmore; second, Pennsylvania State University identified four additional seams that produce "coal that meets the specifications of the 1980 bid solicitation and thus appears to be capable of being burned in Mitchell"; and third, purchase orders for coal for the Mitchell plant suggest additional seams. Exh. 15HH, pages 3-5. Dr. Landon testified that 70% of the additional seams identified by Dr. Kleber "appear to be out-

side . . . the 100 miles 'market' identified by Staff witnesses," and that he saw "no evidence in the record that coal from any of these seams is delivered to electric plants within the Staff designated 'markets'." Exh. 9D, page 12. Dr. Landon also noted that "there is no evidence that coal from these seams was available, and if it were available, at what cost." Id.

Mr. Blackmore did not respond in detail to Dr. Kleber's view about additional coal seams having suitable coal, but on cross-examination he indicated there were coals in "east Kentucky and southern West Virginia, which would comply with the specification of the coal [OPCO was] looking for," but his study did not look at those coals "because out of experience . . . the cost of coal is higher, and the transportation costs would make it uncompetitive." Tr. 520.

There are aspects of OPCO's market study which weaken the belief that comparable prices are being reflected, for example, the relatively small quantities of coal involved, but it is credible evidence that must be considered with all the other evidence in the record.

The Martinka coal price looks better for the future if the prediction made by Mr. Blackmore in his testimony holds up. He testified that the FOB mine price projected for 1983 for Martinka coal was $38.81 per ton Exh. 4, page 19. When compared to the FOB price in 1982 of about $43.24/ton, this is a significant decrease.[7] Mr. Blackmore attributes this decrease to efficient operation of the mine. Id. at 19, 20. Furthermore, a decrease in the transportation costs has been negotiated and this would also add to the decrease in the price delivered to the Mitchell plant. Id. at 21, 22.

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[7] The FOB mine price in 1982 is calculated from a price of 183.2¢/MMBtu testified to by Mr. Blackmore (Exh. 4, page 20) and the assumption the Martinka coal has 11,800 Btu/pound. The formula used is that sponsored by Dr. Kleber in Exh. 15A.

In summary, OPCO has shown by a preponderance of the evidence that over the years 1980-1982 the prices paid for Martinka coal were not unreasonable. The 1981 price for Martinka coal was much higher than the price coal could have been acquired for elsewhere, but the unique problems of that year that afflicted owners of mines rather than those having contract prices which were not affected by the over 2 month strike or peculiar operating problems is the explanation rather than an endemic unreasonableness in the price for the Martinka coal. Furthermore, a preponderance of the evidence shows that the Martinka price may be favorable compared to other market prices in at least the near future.

VII. Ultimate Determination

The inclusion of the prices paid for Martinka coal in the cost-of-service by Ohio Power Company for the years 1980-1982 was reasonable.

(Holding Company Act Release No. 17383)

Administrative Proceeding
File No. 3-3284

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

December 2, 1971

IN THE MATTER OF OHIO POWER COMPANY
Canton, Ohio

CAPTINA OPERATING COMPANY
Moundsville, West Virginia

(70-5090)

(Public Utility Holding Company Act of 1935)

ORDER AUTHORIZING ISSUE AND SALE OF COMMON STOCK BY SUBSIDIARY COMPANY AND ACQUISITION THEREOF BY PARENT UTILITY COMPANY

Ohio Power Company ("Ohio Power"), an electric utility subsidiary company of American Electric Power Company, Inc. ("AEP"), a registered holding company, and Captina Operating Company ("Captina"), a presently inactive wholly-owned subsidiary company of Ohio Power, have filed an application and an amendment thereto with this Commission pursuant to Sections 6(b), 9, and 10 of the Public Utility Company Act of 1935 ("Act") regarding the following proposed transactions.

Captina, a West Virginia corporation, organized in 1956 to, among other things, develop, mine, and sell coal and manage, operate, and maintain steam electric generating stations, has been inactive since December 31, 1966. Captina has 5,000 shares of common stock (par

value $1.00) authorized and 1,000 such shares outstanding and as of June 30, 1971, had total assets of $1,681. Upon authorization of the transactions proposed herein, the name of Captina will be changed to Southern Ohio Coal Company ("Southern Ohio") and Southern Ohio will take the necessary steps to qualify to do business in the State of Ohio and develop and mine such coal reserves either owned by Ohio Power, or which Ohio Power may transfer to it.

Ohio Power has under construction three 1,300.000 kilowatt coal-fired steam electric generating units. In order to assure a reliable supply of coal for these generating facilities, a financing program for Southern Ohio is proposed to permit it to develop and mine various reserves of coal owned or controlled by Ohio Power in southern and eastern Ohio. Southern Ohio proposes to issue and sell, on or before July 1, 1973, 4,000 shares of its common stock, and Ohio Power proposes to acquire such stock for a consideration of $2,500 per share ($10,000,000).

Ohio Power's three 1,300,000 kilowatt units will require in aggregate over 10 million tons of coal per year. It is stated that the most significant coal reserve to be developed and mined by Southern Ohio is Ohio Power's Wellston Coal Field, which has an estimated 270 million tons of recoverable coal. In addition to the Wellston reserve, Southern Ohio will initially commence development and mining of certain other coal reserves, which have an estimated 137 million tons of recoverable coal. All of these coal reserves must be "deep mined." None of the coal to be mined by Southern Ohio will be sold to anyone other than public utility companies in the AEP system.

It is estimated that the development of such coal reserves will require capital expenditures of approximately $20,000,000 through 1973. Additional financing requirements will be the subject of future applications. The charges for coal by Southern Ohio will be based on an amount equal to the actual cost of Southern Ohio in de-

veloping the reserve and mining such coal, including all appropriate overheads and interest charges and including a reasonable rate of return on Ohio Power's equity investment in Southern Ohio. Such rate of return will be no greater than the return then being earned by Ohio Power on equity invested in electric plant as determined pursuant to the then effective Uniform System of Accounts prescribed by the Federal Power Commission for electric utility companies.

No State commission and no Federal commission, other than this Commission, has jurisdiction over the proposed transactions.

Due notice of the filing of said application has been given in the manner prescribed in Rule 23 promulgated under the Act (Holding Company Act Release No. 17350), and no hearing has been requested of or ordered by the Commission. Upon the basis of the facts in the record, it is hereby found that the applicable standards of the Act and the rules thereunder are satisfied and that no adverse findings are necessary; and that it is appropriate in the public interest and in the interest of investors and consumers that said application, as amended, be granted:

IT IS ORDERED, pursuant to the applicable provisions of the Act and rules thereunder, that said application, as amended, be, and it hereby is, granted, effective forthwith, subject to the terms and conditions prescribed in Rule 24 promulgated under the Act and subject further to the proviso that nothing in this order shall be construed as in any manner affecting the jurisdiction of any other regulatory authority with respect to the accounting or similar matters in connection with the proposed transactions.

For the Commission, by the Division of Corporate Regulation, pursuant to delegated authority.

RONALD F. HUNT
Secretary

PUBLIC UTILITY HOLDING COMPANY ACT OF 1931

Release No. 20515 / April 24, 1978

IN THE MATTER OF OHIO POWER COMPANY

SOUTHERN OHIO COAL COMPANY
Canton, Ohio

(70-6090)

ORDER AUTHORIZING TRANSFER OF INVESTMENT IN COAL MINING DEVELOPMENT AND ASSOCIATE FACILITIES FROM UTILITY TO COAL MINING SUBSIDIARY IN EXCHANGE FOR CASH AND LONG-TERM DEBT NOTES OF SAID SUBSIDIARY AND CAPITAL CONTRIBUTION FROM UTILITY TO SAID SUBSIDIARY IN CONNECTION THEREWITH

Ohio Power Company, ("Ohio"), an electric utility subsidiary company of American Electric Power Company, Inc. ("AEP"), a registered holding company and Southern Ohio Company ("SOhio"), a coal mining subsidiary company of Ohio, have filed an application-declaration and amendments thereto with this Commission, pursuant to Sections 6, 7, 9, 10 and 12 of the Public Utility Holding Company Act of 1935 ("Act") and Rule 50(a)(3) promulgated thereunder regarding the following proposed transactions.

SOhio is engaged in the development of coal reserve owned or controlled by Ohio. By order of this Commission (HCAR No. 17383, December 2, 1971) SOhio was authorized to issue and sell, and Ohio was authorized to acquire, 4,000 shares of SOhio's common stock for a consideration of $2,500 per share ($10,000,000). Pursuant to such order, Ohio has purchased 4,000 shares of SOhio's common stock. SOhio commenced the develop-

ment of the Meigs Mines, located in southeastern Ohio, in 1971. In order to further these activities Ohio itself subsequently engaged in mine development work and the construction of associated facilities both at the Meigs Mine complex and at the Martinka Mines. SOhio however, remained and still remains, the actual operator of these mines and facilities.

SOhio is developing Ohio's coal resources in order to assure a reliable supply of coal for Ohio's generating facilities in general, including the Mitchell Plant at Captina, West Virginia and the Ohio Electric Company's General James M. Gavin Plant at Cheshire, Ohio. The Gavin Plant, which is owned by Ohio Electric Company, wholly-owned subsidiary of Ohio, consists of two 1,300,000 kilowatt coal-fired steam electric generating units and receives coal from the Meigs Mine complex. Ohio's Mitchell Plant consists of two coal-fired generation units with a combined capacity of 1,460,000 kilowatts (Unit 1 is rated at 660,000 kw and Unit 2 is rated at 800,000 kw), and receives coal from the Martinka Mines. The Gavin Plant's annual coal requirement is 7.5 million tons per year, while the Mitchell Plant's need is 4.0 million tons. Coal being delivered to these respective plants from the Meigs Mines complex and the Martinka Mines conforms with the federal plan for sulfur dioxide emissions control. A large part of the 11.5 million tons of coal required annually for these units is being supplied from coal reserves owned by Ohio so as to assure an adequate and reliable fuel supply for these plants. The major coal reserves currently being developed by SOhio are the Wellston Reserve located in Meigs, Gallia and Vinton Counties, Ohio and the Hillman Reserve in Marion County, West Virginia. The combined reserves cover approximately 77,000 acres and have a total reserve base of 705,000,000 tons. The Wellston Reserve, currently being mined by SOhio's Meigs Division, consist of 60,229 acres with an estimated reserve base of 545,831,000 tons of coal from the Clarion 4-A seam. The

estimated recoverable clean reserve (reflecting current mining techniques and preparation plant operations) is approximately 212,874,000 tons of coal. The Hillman Reserve, currently being mined by SOhio's Martinka division, consists of 16,314 acres with an estimated reserve base of 159,149,000 tons of coal from the Lower Kittanning seam and with an estimated recoverable clean reserve of 71,090,000 tons.

It is proposed that Ohio convey its entire investment in coal mining development and associated facilities at the Meigs Mines complex and the Martinka Mines at its net book value as of the first day of the month in which the transaction is accomplished. As of March 1, 1978, the net book value of the property proposed to be transferred was $260,176,293. Included among the assets to be transferred are the Meigs overland conveyor connecting the Meigs Mines to the Gavin Plant, the intermine conveyor between Meigs Mine Nos. 1 and 2, preparation plants and related facilities, surface lands and mineral rights and development costs. Ohio also proposes to assign to SOhio all coal leases held in the Hillman Reserve at the Martinka Mines. Ohio shall continue to remain secondarily liable for such leases.

Certain issues with respect to these assets are involved in a suit filed by the Commission on March 3, 1978 (SEC v. AEP, et al., U.S.D.C., D.C. Civil Action No. 78-0384). The defendants, including Ohio, have agreed to a Consent Order and, pursuant to their Undertaking and Stipulation, will appoint a Special Auditor to investigate, *inter alia*,. acquisition of certain of these assets and or charges relating thereto. Upon completion of this investigation, the Special Auditor will issue a written report ("Special Auditor's Report") as to his findings and recommendations. Jurisdiction will be reserved to make any appropriate adjustments in light of the Special Auditor's Report.

It is further proposed that, in exchange for the conveyance of such investment by Ohio to SOhio, SOhio will

issue long-term debt notes and pay cash to Ohio, the cash portion to be offset by a capital contribution in an equal amount to be made by Chio to SOhio, so as to establish a debt-equity ratio in SOhio equal to the average debt-equity ratio of Ohio during the period such investment was made (combining for such purpose preferred stock and common equity), 52% long-term debt, 13% preferred stock, and 35% common equity.

The price at which SOhio coal is sold to AEP system companies will not exceed the cost therof to the seller. For this purpose, cost will include reasonable compensation for necessary capital which will be determined from Ohio's overall cost of capital by applying to the seller's capital represented by Ohio's investment being transferred to SOhio, as well as the investment previously made by Ohio in SOhio, whether debt or equity, a composite rate of return computed by applying to Ohio's average capital structure during the period 1971 to 1976, in which time investments were made, an interest rate on long-term debt equal to the weighted average of effective interest costs of Ohio's bond issues during this period (9.16%), a preferred dividend rate equal to the weighted average of effective dividend rates of Ohio's preferred stock issues during this period (9.70%) and a return on common equity not to exceed the rate of return on common equity specified by the Federal Energy Regulatory Commission (FERC) in the most recent wholesale rate proceeding involving Ohio. In the absence of such a determination at this time, it is proposed that the cost of common equity capital of SOhio be set at 13% until such time as FERC shall then become applicable on a prospective basis to the then total common equity investment of Ohio in SOhio. Applicants-declarants cite recent retail rate decisions by two state utility commissions involving other AEP system companies in which rates of return on common equity of 13%-13.5% were approved.

It is further stated that upon completion of the transfer of such investment SOhio will require approximately $10,000,000 from the proposed date of transfer to December 31, 1980, to complete the capital improvement program presently underway at the Meigs and Martinka Mines. Authorization therefor is also being sought for Ohio to make investments in SOhio from time to time on or before December 31, 1980, in an aggregate amount of $10,000,000.

The return on such additional investment as well as the investment previously made in SOhio by Ohio will be determined from Ohio's overall cost of capital by applying of such investments, whether debt of equity, a composite rate of return computed by applying to Ohio's capital structure as of the end of the year preceding the investment, an interest rate on long-term debt equal to the effective interest cost of Ohio's capital structure as of the end of the year preceding the investment, an interest rate on long-term debt equal to the effective interest cost of Ohio's last bond issue preceding the investment, a dividend rate on preferred stock equal to the effective dividend cost of Ohio's last preferred stock issue preceding the investment and a return on common equity as described above.

No state or federal commission, other than this Commission, has jurisdiction over the proposed transactions. Fees and expenses to be incurred in connection with the proposed transactions are estimated at $28,000.

Due notice of the filing of said application-declaration has been given in the manner prescribed in Rule 23 promulgated under the Act (HCAR No. 20274), and no hearing has been requested of or ordered by the Commission. Upon the basis of the facts in the record, it is hereby found that the applicable standards of the Act and the rules thereunder are satisfied and that no adverse findings are necessary; and that it is appropriate

and in the public interest and in the interest of investors and consumers that said application-declaration, as amended, be granted and permitted to become effective:

IT IS ORDERED, pursuant to the applicable provisions of the Act and rules thereunder, that said application-declaration, as amended, be, and it hereby is, granted and permitted to become effective forthwith, subject to the terms and conditions prescribed in Rule 24 promulgated under the Act, except that Ohio and SOhio shall file reports providing, as to activities during each quarter: (a) corporate balance sheets and income statements for SOhio, including descriptions of the operations and capital improvement program undertaken during the quarter; (b) the quantities of coal sold to each buyer, the price of such coal and the method used to compute the cost of coal sold; and (c) such other matters and in such form as may be requested by the Commission from time to time.

IT IS FURTHER ORDERED that jurisdiction be and hereby is reserved with respect to any adjustments made necessary by the Special Auditor's Report pertaining to acquisition of coal mining assets here involved and or charges relating thereto.

For the Commission, by the Division of Corporate Regulation, pursuant to delegated authority.

GEORGE A. FITZSIMMONS
Secretary

PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

Release No. 21008/April 17, 1979

IN THE MATTER OF SOUTHERN OHIO COAL COMPANY
Moundsville, West Virginia

OHIO POWER COMPANY
Canton, Ohio

(70-6215)

ORDER AUTHORIZING FINANCING FOR COAL MINING SUBSIDIARY

Ohio Power Company ("Ohio Power"), an electric utility subsidiary of American Electric Power Company, Inc. ("AEP"), a registered holding company, and Southern Ohio Coal Company ("SOCO"), a coal mining subsidiary of Ohio Power, have filed with this Commission an application-declaration and amendments thereto pursuant to Sections 6, 7, 12(b), 12(c) and 12(f) of the Public Utility Holding Company Act of 1935 ("Act") and Rules 42, 45, 46 and 50 promulgated thereunder concerning the following proposed transactions.

SOCO is engaged exclusively in developing and mining coal reserves owned by Ohio Power and in supplying coal for use at Ohio Power's Mitchell Plant at Captina, West Virginia and at the General James M. Gavin Plant at Cheshire, Ohio, which plant is owned by Ohio Electric Company, a generating subsidiary of Ohio Power. Applicants-declarants seek authorization for a set of financial transactions involving the following:

(1) SOCO's borrowing up to $130,000,000 from a group of banks from time to time through December 31, 1980, pursuant to a term loan agreement ("Loan Agreement")

and issuing its promissory notes ("Notes") in connection with such borrowings;

(2) SOCO's applying the proceeds from such borrowings as follows:

(a) 52% of such amount to Ohio Power to prepay a portion of the promissory note of SOCO held by Ohio Power; and

(b) 48% of such amount to Ohio Power as a distribution from capital surplus with respect to SOCO's outstanding shares of common stock; and

(3) Applicants-declarants' executing various documents in connection with the borrowing, including a subordination agreement ("Subordination Agreement"), capital funds agreement ("Capital Funds Agreement") and a letter to the lending banks giving assurances as to continued ownership of certain assets.

The banks and the amounts of their proposed commitments are as follows:

Bank	Amount
Citibank	$30,000,000
Chase Manhattan Bank	20,000,000
Chemical Bank	20,000,000
Continental Illinois National Bank and Trust	20,000,000
Irving Trust Company	20,000,000
Manufacturers Hanover Trust Company	20,000,000
	$130,000,000

Each borrowing by SOCO under the Loan Agreement will be made pro-rata from among the banks in proportion to their respective commitment. The Notes evidencing such borrowings will mature in installments from March 31, 1980, through December 31, 1986, and will provide for installments totalling 15% of the principal amount thereof that is unpaid on December 31, 1980, in

each of the years 1981 through 1985 and 25% of such principal amount in 1986; such annual installments to be paid in equal quarterly amounts on March 31, June 30, September 30 and December 31 in each year. Interest on the unpaid principal balance of the Notes will be payable quarterly and at maturity at the rate per annum equal to 109% of Citibank's prime rate for 90-day loans to responsible and substantial commercial borrowers. Interest after the principal of the Notes shall have become due (whether by acceleration or otherwise) will be payable at a rate per annum equal to the greater of 6% of 2% plus Citibank's prime rate. Each bank shall also receive a commitment fee of ½ of 1% per annum on the daily average unused amount of the bank's commitment, computed from the date of the Loan Agreement.

The Notes will be prepayable, in whole or in part, at any time without premium or penalty. The Loan Agreement requires prepayment in the event the Coal Supply Agreement among SOCO, Ohio Power and Ohio Electric to the Capital Funds Agreement (which is discussed further below) should either cease to be fully enforceable or terminate. The Notes are also prepayable in full at the election of the banks upon the occurrence of certain events of default specified in the Loan Agreement.

To induce the Banks to enter into the Loan Agreement, applicants-declarants propose to enter into the Subordination Agreement with the banks which will provide that so long as any of the Notes remain outstanding, all indebtedness and obligations of SOCO to Ohio Power, including SOCO's 9.16% promissory notes in the principal amount of $142,721,664 due April 1, 2008 (the "9.16% Note"), shall be subordinate and junior in right of payment to all indebtedness of SOCO evidenced by the Notes. The Subordinate Agreement would not prevent SOCO from paying principal or interest on any indebtedness or obligations to Ohio Power as they become due as long as SOCO is not in default under the Loan Agreement or

the Notes, or unless such payments would result in such a default.

The proposed Capital Funds Agreement provides in substance that Ohio Power shall supply or cause to be supplied to SOCO such amounts of capital from time to time during the term of the Coal Supply Agreement as, when added to amounts received by it from other sources, will be sufficient to enable SOCO to pay when due all of its operating and other expenses, including any amount which SOCO may be required to pay for interest on all indebtedness (which would include the Notes) and on account of stated maturities of, and/or all required sinking fund payments and other regular amortization requirements applicable to such indebtedness (which would include the installments of principal on the Notes but not any amount applicable to principal which might become due in the event of acceleration of maturity of the Notes other than installments of principal which would have become due but for such acceleration). Any capital that Ohio Power may be required to supply to SOCO under the Capital Funds Agreement shall be furnished in cash in the form of (a) a capital contribution with respect to the common stock of SOCO and (b) a loan to SOCO evidenced by a promissory notes maturing not less than 20 nor more than 30 years from the date of issuance and bearing interest, payable semiannually, at a rate per annum equal to the effective interest cost of the latest series of first mortgage bonds issued by Ohio Power prior to the date of issuance of such note. The amounts of such capital represented by the capital contribution and by the loan, respectively, shall be in such proportions as at the time may be authorized by this Commission (or any successor regulatory authority).

SOCO proposes to apply 52% of the amount of each borrowing from the banks under the Loan Agreement to prepay a portion of the principal amount of its 9.16% Note held by Ohio Power and to pay the remaining 48%

of such amount as a distribution from capital surplus with respect to its outstanding shares of common stock, all of which are held by Ohio Power. Assuming the borrowing of the full $130,000,000, the effect on SOCO's capitalization (excluding current liabilities) as of June 30, 1978, would be as follows (in millions):

	Per Books 6/30/78	Adjustments	Pro Forma 6/30/78
Long-Term Debt:			
Note Payable to Ohio Power	$142.7	(67.6)	$ 75.1
Notes Payable to Banks	—	130.0	130.0
	$142.7		$205.1
Equity:			
Common Stock, including premium	$ 10.0		10.0
Other Paid-in Capital	117.6	(62.4)	55.2
Retained Earnings	7.4		7.4
	$135.0		$ 72.6
Total Capitalization	$277.7		$277.7

SOCO's present capitalization was created in compliance with this Commission's order of April 24, 1978 (HCAR No. 20515 in File No. 70-6090), which order approved the conveyance to SOCO of Ohio Power's entire investment in coal mining development and associated facilities at the Meigs Mines complex and the Martinka Mines at the net value of such assets on Ohio Power's books. The consideration of approximately $260,200,000 paid by SOCO for such assets consisted of the 9.16% Note and cash provided by a capital contribution from Ohio Power, in proportions calculated to establish a debt-equity ratio in SOCO equal to the average debt-equity ratio of Oho Power during the period that its investment in the assets transferred was made (52% long-term debt and 48% preferred stock and common equity).

The April 24, 1978, order also provided that the price at which coal is sold by SOCO to AEP system companies should not exceed SOCO's cost, including reasonable com-

pensation for necessary capital calculated in accordance with a formula prescribed in such order. Under the prescribed formula the rates of return allowed on the debt and equity component of Ohio Power's initial investment have been calculated to be 9.16% and 12.11%, respectively. These two rate result in a composite rate of 10.58% after federal income tax and 11.51% including a provision for federal income taxes at the rate of 13.8% (which is the minimum effective rate based upon a 46% tax rate and the maximum 70% investment tax credit offset).

It is stated that by increasing the amount of debt capital in SOCO (the interest on which is deductible for tax purposes) in relation to the amount of its equity capital, it is anticipated that the proposed borrowings under the Loan Agreement should, over its term, produce a net reduction in the cost of coal supplied by SOCO to AEP system companies. During periods when the prime rate is below 9.71%, the borrowers by SOCO would result in a reduction in the cost of coal, regardless of federal income tax effect.

During periods when the prime rate is 9.71% or above, any reduction in the cost of coal would depend on the effective tax rate applicable to SOCO. Assuming an effective tax rate of 13.8%, the "break-even" prime rate under the proposal is 10.56%.

It is proposed that during months in which the average prime rate applicable is in excess of 10.5%, SOCO would use a cost of capital component, including provision for federal income taxes, of 11.51%, to be applicable to the total capital of SOCO, including term loans outstanding. During months in which the average prime is 10.5% or less, SOCO would use the actual borrowing cost applicable to the term loans and a cost of capital, including provision for federal income taxes, of 11.51%, applicable to the debt and equity capital provided by Ohio Power.

It is stated that under these conditions the cost of coal sold by SOCO would not include costs of capital that were in excess of the amounts currently authorized in File 70-6090, and, during the periods when the prime rate had declined to more normal historical levels, the result would be substantial reductions in the effective cost of coal. It is further stated that the price of coal supplied by SOCO to AEP system companies, including Ohio Power, shall not include a cost of capital with respect to the total debt (including the Notes) and equity of SOCO in excess of the presently allowed composite rate of 10.58% after taxes. SOCO will not defer, through a memorandum account or otherwise, its capital costs in excess of the allowable rate of return, or charge such excess costs to the cost of coal in any subsequent period.

In addition to a possible coal price reduction, the proposed transactions, through the prepayment of part of the 9.16% Note and the payment of a distribution of capital surplus on SOCO's common stock, would provide Ohio Power with funds for the repayment of short-term debt and for construction purposes. The receipt of such funds would reduce commensurately Ohio Power's financing requirement during a period in which it is anticipated that Ohio Power may be restricted in its ability to raise capital through the issuance of first mortgage bonds (it presently lacks the 2.0 interest coverage required for such issuance, a condition expected to continue well into 1979) as a result of delays in receiving adequate rate increases. Ohio Power states that its estimated external financing requirements for 1979 aggregate approximately $210,000,000, including $40,000,000 of maturing first mortgage bonds. Its present anticipated resources for the net $170,000,000 needed consist of a possible $40,000,000 sale of preferred stock (which will be the subject of a future application to this Commission) and a proposed $50,000,000 cash capital contribution from AEP, which was authorized by Commission order dated December 29, 1978 (HCAR No. 20865).

Applicants-declarants state that they consent to a provision to the effect that the borrowings by SOCO under the Loan Agreement shall be prepaid on or before December 31, 1979, unless such borrowings are permitted for a longer period by further Commission order.

The fees and expenses to be incurred in connection with the proposed transactions are estimated at $7,000, including legal fees of $2,500. The Public Utilities Commission of Ohio has authorized the proposed transactions. No other state commission and no federal commission, other than this Commission, has jurisdiction over the proposed transactions.

Due notice of the filing of said application-declaration has been given in the manner prescribed in Rule 23 promulgated under the Act (HCAR No. 20802), and no hearing has been requested of or ordered by the Commission. Upon the basis of the facts in the record, it is hereby found that the applicable standards of the Act and the rules thereunder are satisfied and that no adverse findings are necessary; and that it is appropriate in the public interest and in the interest of investors and consumers that said application-declaration, as amended, be granted and permitted to become effective:

IT IS ORDERED, pursuant to the applicable provisions of the Act and rules thereunder, that said application-declaration, as amended, be, and it hereby is, granted and permitted to become effective forthwith, except that the Notes shall be prepaid on or prior to December 31, 1979, unless the borrowings are permitted for a longer period by further order of this Commission, subject to the terms and conditions prescribed in Rule 24 promulgated under the Act.

For the Commission, by the Division of Corporate Regulation, pursuant to delegated authority.

GEORGE A. FITZSIMMONS
Secretary

PUBLIC UTILITY HOLDING COMPANY ACT OF 1935
Release No. 21537/April 25, 1980

In the Matter of SOUTHERN OHIO COAL COMPANY
Moundsville, West Virginia

OHIO POWER COMPANY
Canton, Ohio

(70-6409)

ORDER AUTHORIZING PROPOSED FINANCING FOR COAL MINING SUBSIDIARY

Ohio Power Company ("Ohio Power"), an electric utility subsidiary company of American Electric Power Company, Inc. ("AEP"), a registered holding company, and Southern Ohio Coal Company ("SOCO"), a coal mining subsidiary of Ohio Power, have filed an application-declaration and amendments thereto with this Commission, pursuant to Sections 6, 7, 9, 10 and 12 of the Public Utility Holding Company Act of 1935 ("Act") and Rule 50 promulgated thereunder concerning the following proposed transactions.

SOCO is engaged in the development and mining of coal reserves for use at Ohio Power's Mitchell Plant located in Captina, West Virginia, and at its General James M. Gavin Plant, located in Cheshire, Ohio. The transaction proposed herein involves the installation by SOCO of additional coal preparation facilities at its Meigs Mine Complex located in Gallia and Meigs Counties in southeastern Ohio. SOCO proposes to 1) install at Meigs Mine No. 1 a heavy-medium cyclone and a froth flotation system to augment the heavy-medium bath preparation; 2) install at Racoon Mine No. 3 a froth flotation system; and 3) modify the Baum jig plant at Racoon Mine No.

3. These additions and modifications are estimated to cost approximately $40,600,000.

Ohio Power and SOCO believe that the cost of the proposed project is justifiable on the basis of the anticipated savings in the cost of coal delivered to Ohio Power. In the case of Meigs Mine No. 1, the preparation plant additions will lead to improved quality of the coal and to a relative reduction in the cost per million British thermal units ("MBtu") of delivered coal. It is estimated that such cost in present-day dollars will be reduced from $181.75 per MBtu to $175.61 per MBtu. The Racoon Mine No. 3 addition will cause an increase in Btu recovery and an estimated decline in relative delivered cost per MBtu in present-day dollars from $170.98 to $157.77. The annual savings in delivered fuel costs alone upon completion of the proposed projects are estimated to be approximately $16,674,000 at capacity or planned output. Additional savings will accrue annually to Ohio Power through improved availability and lower maintenance expense of the Gavin Plant boilers. Although these savings are difficult to quantify precisely, they are conservatively estimated at $10 million annually. It is proposed that these projects will be financed through a combination of long-term loans and cash capital contributions by Ohio Power to SOCO of $40,600,000. It is expected that Ohio Power will make its investment in SOCO in two increments, one to be made in 1980 and the second to be made sometime in 1981. In return for the loans, SOCO will issue to Ohio Power long-term promissory notes. Each of the notes will mature and become payable on December 31, 2009.

The price at which SOCO's coal will be sold to AEP system companies will not exceed the cost thereof to the seller. For this purpose, cost will include reasonable compensation for necessary capital.

The investments made by Ohio Power in SOCO will be assumed to be made in the same proportion as the debt-

equity ratio of Ohio Power at the end of the year prior to the investment. As of December 31, 1979, the debt-equity ratios of Ohio Power were 56.3% long-term debt, 11.9% preferred stock, and 31.8% common equity. The interest rate on long-term debt will be equal to the effective interest cost of Ohio Power's last issue of First Mortgage Bonds prior to the investment, the preferred dividend rate will be equal to the dividend rate of Ohio Power's last issue of preferred stock prior to the investment, and the return on common equity will not exceed the rate of return on common equity specified by the Federal Energy Regulatory Commission (FERC) in the most recent wholesale rate proceeding involving Ohio Power. In the absence of such a determination at this time, it is proposed that the cost of common equity capital of SOCO be set at 13% until such time as FERC should take action specifying a rate of return in a wholesale rate proceeding involving Ohio Power in which case the rate then established by FERC shall then become applicable on a prospective basis to the then total common equity investment of Ohio Power in SOCO. The allowed rate of return on common equity shall not be applied to any of SOCO's retained earnings. No return allowance will be applied to such retained earnings.

It is stated that the issuance of such securities is excepted from the competitive bidding requirements of Rule 50 by reason of paragraph (a)(3) thereof.

The fees and expenses to be incurred in connection with the proposed transactions are estimated at $2,500. No state commission and no federal commission, other than this Commission, has jurisdiction over the proposed transactions.

Due notice of the filing of said application-declaration has been given in the manner prescribed in Rule 23 promulgated under the Act (HCAR No. 21499), and no hearing has been requested of or ordered by the Commission. Upon the basis of the facts in the record, it is

hereby found that the applicable standards of the Act and the rules thereunder are satisfied and that no adverse findings are necessary; and that it is appropriate and in the public interest and in the interest of investors and consumers that said application-declaration, as amended, be granted and permitted to become effective:

IT IS ORDERED, pursuant to the applicable provisions of the Act and rules thereunder, that said application-declaration, as amended, be, and it hereby is, granted and permitted to become effective forthwith, subject to the terms and conditions prescribed in Rule 24 promulgated under the Act.

For the Commission, by the Division of Corporate Regulation, pursuant to delegated authority.

GEORGE A. FITZSIMMONS
Secretary

THIS INDENTURE, dated as of the first day of October, 1972, by and between Ohio Power Company, an Ohio corporation (hereinafter referred to as "Power Company"), and Southern Ohio Coal Company, a West Virginia corporation duly qualified in Ohio (hereinafter referred to as "Coal Company").

WITNESSETH:
THAT,

WHEREAS, Power Company and/or Coal Company have acquired, are now acquiring and expect to acquire in the future, ownership or control of large areas of land situate in the counties of Meigs, Gallia and Vinton, and in other counties in the State of Ohio, and elsewhere, which lands are underlain with bituminous coal; and

WHEREAS, Coal Company was organized for the purpose, among other things, of mining, producing, transporting, and selling coal; and Coal Company desires the right and privilege of mining and selling coal from the said lands of Power Company; and

WHEREAS, Power Company requires large quantities of coal in the conduct of its business; and Power Company is willing to grant to Coal Company the right and privilege of mining and selling coal from the lands of Power Company provided Coal Company will sell to Power Company, and/or to any subsidiary corporation of Power Company or any affiliated corporation of the American Electric Power System designated by the Power Company, the entire output of coal from both Power Company's and Coal Company's lands.

NOW, THEREFORE, for and in consideration of the sum of Ten Dollars ($10.00) and other good and valuable considerations in hand paid by Coal Company to Power Company, the receipt of all of which is hereby acknowledged, and subject to the covenants, conditions,

terms and agreements hereinafter set forth, Power Company hereby grants unto Coal Company the right and privilege to mine, extract, remove, prepare and to sell for its own benefit and profit all of the coal in and underlying certain lands of Power Company situate in the counties of Meigs, Gallia and Vinton and in other counties in the State of Ohio and elsewhere, to be more particularly designated and described as hereinafter set forth; together with the right to enter upon said lands and to construct, operate and use thereon all such works, buildings, plants, structures, equipment, machinery and appliances as may be necessary, useful or convenient for the mining, preparation and transporting of the coal; also the right to do anything in and upon said lands that may be necessary, useful, convenient and proper in the exercise of the rights and privileges herein granted.

The rights and privileges herein granted shall continue for a period of 35 years from and after the date hereof and from year to year thereafter.

This indenture shall not be terminated by either party for a period of 35 years from and after the date hereof for any reason whatsoever except to the extent that performance may conflict with any rule, regulation, or order of the Securities and Exchange Commission under the Public Utility Holding Company Act of 1935. Either party hereto shall have the right to terminate this indenture at the end of 35 years after the date hereof by giving to the other party written notice of its intention so to do at least ninety (90) days prior to the date of such termination.

The parties hereto hereby covenant and agree as follows:

1. Power Company will, from time to time, designate in writing such lands it owns or controls that are to be subject to the terms and provisions of this indenture. Such written designations shall be in sufficient detail to

enable Coal Company to identify the lands, and to ascertain the extent of Power Company's ownership or control of the lands therein designated and described. Such written designations shall be signed by the duly authorized officers of Power Company, and delivered to Coal Company; and they shall be identified as being supplemental to this indenture. Title to coal mined by Coal Company from lands owned by Power Company shall, upon severance from the land, pass to Coal Company.

2. Coal Company shall sell and deliver to Power Company, and Power Company shall receive, accept and pay for all of the coal produced by Coal Company from the lands owned or controlled by Power Company or by Coal Company during the continuance of this indenture. Power Company shall have the right to designate any of its subsidiary corporations and/or any affiliated corporations of the American Electric Power System to receive, accept and pay for any portion of such coal, but this shall not relieve Power Company of its obligation to make payments for coal required hereunder.

3. The price to be paid by Power Company to Coal Company for the coal sold and delivered hereunder shall be an amount of money equal to the entire cost to Coal Company of mining, preparing and delivering such coal, including, but not limited to, depreciation, lease payments, amortization, the cost of developing the reserves, all appropriate overheads and interest charges, and including a reasonable rate of return, after taxes payable by Coal Company, on Power Company's equity investment in Coal Company, which will be no greater than the return then being earned by Power Company on equity invested in electric plant as determined pursuant to the then effective uniform System of Accounts prescribed by the Federal Power Commission for electric utility companies.

4. Payments for the coal sold and delivered hereunder shall be made by Power Company on or before the twen-

tieth (20th) day of each month for all coal delivered during the preceding month. Notwithstanding the foregoing, if, for any reason whatsoever Coal Company shall fail in any month to sell and deliver tonnage of coal to Power Company sufficient to pay the entire cost of Coal Company for such month, Power Company shall pay as advance payment for coal the amounts necessary for Coal Company to meet its entire costs for such month.

In the event of non-performance by either party due to circumstances, in the judgment of the parties, are such as to excuse unconditionally all future performances by such party, this indenture shall terminate. In the event of such termination or of any other termination, by breach or otherwise, of this indenture by either party, Power Company shall pay any cost of Coal Company which may arise by reason of such termination.

5. Coal Company shall maintain and keep a complete record of the number of tons of coal mined and sold from the lands of both Power Company and Coal Company. Coal Company shall also establish and maintain a set of accounts, satisfactory in form to Power Company, showing the actual cost to Coal Company of mining, preparing and delivering the coal hereunder. Such records and accounts shall be available for examination by Power Company at all reasonable times.

6. Power Company shall supply or cause to be supplied to Coal Company such amounts of capital as shall be required in connection with the development of the coal reserves, including all related facilities necessary for the mining, cleaning, storing and transportation of the coal to be minded, to provide for pre-operating expenses of Coal Company, and to permit continuation of the mining, preparation and delivery of coal hereunder.

7. Coal Company shall not assign the rights and privileges herein granted, in whole or in part, without the written consent of Power Company.

8. Coal Company shall not use its lands or those of the Power Company, nor permit the same to be used,

in any illegal way or for any illegal purpose; and, in the conduct of its operations upon such lands, Coal Company shall comply with all applicable laws, rules and regulations of governmental bodies having jurisdiction in the premises. Coal Company shall also use mining methods conforming to best industry practice in the circumstances and take action necessary and required to minimize environmental effects.

9. Coal Company shall and will indemnify and save harmless Power Company from and against all claims for injuries, including death, or damage to any person or property by reason of the violation of any provision of this indenture, or which may arise out of the exercise of any of the rights and privileges herein granted, or any acts or omissions of Coal Company, its employees, agents or contractors. Coal Company shall furnish and maintain during the continuance of this indenture, and in form satisfactory to Power Company, policies of insurance covering the risk of claims for injuries or damages as aforesaid; but all premiums paid or payable by Coal Company for such policies of insurance shall be included in the cost to Coal Company of mining, preparing and delivering coal hereunder, and shall become a part of the price to be paid by Power Company for coal as hereinbefore provided.

IN WITNESS WHEREOF, the parties hereto have caused their corporate names to be hereunto signed and their corporate seals to be hereunto affixed and attested by their proper officers thereunto duly authorized, this the day and year first above written.

Attest:

/s/ [Illegible]

OHIO POWER COMPANY

By /s/ G. V. Patterson
Vice President

Attest:

/s/ [Illegible]

SOUTHERN OHIO COAL COMPANY

By /s/ [Illegible]
Vice President

AEP
OHIO
POWER

April 24, 1989

Ms. Lois Cashell
Secretary
Federal Energy Regulatory Commission
825 North Capitol Street, N.E.
Washington, D.C. 20426

Dear Secretary Cashell:

On April 30, 1987, the Federal Energy Regulatory Commission issued an order in FERC Docket Nos. ER82-553-000 and ER82-554-000 (Opinion No. 272). This order reversed an initial decision concerning the reasonableness of Ohio Power Company's (OPCo) purchases of coal from an affiliate, and ordered OPCo to refund the difference between amounts collected subject to refund and amounts payable under the revised rates. By its Opinion No. 272-A, the Commission denied rehearing on this matter.

On May 6, 1988, OPCo refunded, including interest, $2,372,105.29 to its 15 municipal customers (Municipals) for the billing period December 28, 1982 through February 29, 1988. Beginning April 1, 1988, their bills reflected the new rates. Due to the time lag of receiving FERC Form 423 data (approximately 3 months after month closing), a refund of $23,528.40 including interest for March 1988 was not issued until June 3, 1988.

On May 6, 1988, OPCo refunded, including interest, $10,394,222.88 to Wheeling Power Company (WPCo) for the billing period July 29, 1982 through January 31, 1988. Beginning April 1, 1988, Wheeling's bill reflected the new rates. The FERC Form 423 time lag as well as a billing lag different than that for the municipals, required a refund including interest of $91,838.87 for February and $82,357.83 for March 1988, issued on June 3, 1988 and July 5, 1988, respectively.

Subsequent to the refunds made pursuant to its May 6, 1988 filing, OPCo submitted a Revised Compliance Filing that corrected certain errors in the refund calculations. Additional refunds were made to the Municipals and WPCo in the amount of $68,990.81 and $328,998.70, respectively, on September 16, 1988.

On February 22, 1989, the Federal Energy Regulatory Commission issued an Order in FERC Docket Nos. ER82-553-004 and ER82-554-004.

The Order directed OPCo to recalculate the refunds due to the municipal customers and WPCo, and to resubmit its Compliance Filing reflecting revised calculations, in accordance with that Order.

The total refund supported by this Revised Compliance Filing is as follows:

	Refunds thru July, 1988	Sep. 16, 1988	Total Refunds Paid	Amount of Excess Refunds
Municipals	$ 2,395,633.69	$ 68,990.81	$ 2,464,624.50	$ 571,250.14
WPCo	10,568,419.58	328,988.70	10,897,408.28	2,816,851.85

Attached to this letter are the following items:

1) Service List;

2) A Form of Notice suitable for publication in the Federal Register;

3) Volume I, consisting of a summary and detail calculations of refunds to the Municipals; computed as the difference between the actual fuel clause billings and the billings that would have occurred had OPCo substituted market prices for captive prices in the calculation of the Fuel Adjustment clause;

4) Volume II, consisting of the Market Price calculations and supporting details including the price of contract coal delivered at each of the plants

within a 50 mile radius of the Mitchell Plant, with supporting Form No. 423 line and page numbers, and the calculations of the weighted average costs of coal at the Mitchell Plant reflecting those market prices.

5) Volume III, consisting of a summary and detail calculations of refunds to WPCo; computed as the difference between the actual fuel clause billings and the billings that would have occurred had OPCo substituted market prices for captive prices in the calculation of the Fuel Adjustment clause;

6) Volume IV, consisting of the Market Price calculations and supporting details including the price of contract coal delivered at each of the plants within a 50 mile radius of the Mitchell Plant, with supporting Form No. 423 line and page numbers, and the calculations of the weighted average costs of coal at the Mitchell Plant reflecting those market prices.

Upon approval by the Commission of the substitute refund calculations, Ohio Power will institute a monthly surcharge calculated to recover the excess refunds over a one-year period.

Copies of this Revised Compliance Filing have been sent to the Public Service Commission of West Virginia and the Public Utilities Commission of Ohio, as well as the other individuals indicated on the attached service list.

Correspondence or communications with respect to this submittal should be addressed to:

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American Electric Power Service Corp.
One Riverside Plaza
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Respectfully submitted,

/s/ R. J. Pelger
R. J. PELGER
Tariffs, Rates &
Contracts Director

RJP:vac
Enclosures